

**PRINCIPLES, DEFINITIONS AND MODEL RULES
OF EUROPEAN PRIVATE LAW**

Draft Common Frame of Reference (DCFR)

Articles and Comments

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INTRODUCTION

General

1. ***DCFR and CFR distinguished.*** In this volume the Study Group on a European Civil Code and the European Research Group on Existing EC Private Law (the ‘Acquis Group’) present the first academic Draft of a Common Frame of Reference (DCFR). It contains Principles, Definitions and Model Rules of European Private Law. Among other goals its completion fulfils an obligation to the European Commission undertaken in 2005. The Commission’s Research Directorate-General funded part of the work. One purpose of the text is to serve as a draft for drawing up a ‘political’ Common Frame of Reference (CFR) which was called for by the European Commission’s ‘Action Plan on A More Coherent European Contract Law’ of January 2003¹. As is explained more precisely below, the DCFR and the CFR must be clearly distinguished. The DCFR serves several other important purposes.
2. ***Articles and Comments only.*** This version of the DCFR contains Articles and Comments on the topics noted below but no separate sections containing notes on the national laws. A later version will be completed with additional material in the form of model rules in Book IV on certain further specific contracts and the rights and obligations arising from them, and in Books VIII to X on selected matters of property law. It will also contain extensive national notes. The European Commission has also received a substantial part of the extensive comparative legal material which has been gathered and digested in the past years. It is too early at present, however, for all of this comparative material to be made publicly available. The tight timeframe has not made it possible at this time to edit all the notes in a manner commensurate with the standards to be expected.
3. ***The unofficial Interim Outline Edition.*** The two Groups are arranging for an unofficial publication of an Interim Outline Edition containing the Articles (without comments) with a view to making a compact paperback version of the text itself widely available for discussion, comment and criticism.
4. ***An academic, not a politically authorised text.*** It must be stressed that this text originates in an initiative of European legal scholars. It amounts to the compression into rule form of decades of independent research and co-operation by academics with expertise in private law, comparative law and European Community law. The independence of the two Groups and of all the contributors has been maintained and respected unreservedly throughout. That in turn has made it possible to take on board many of the suggestions received in the course of meetings with stakeholders who indicated weaknesses in early working papers. The two Groups alone bear responsibility for the content of this

¹ COM (2003) final, OJ C 63/1 (referred to below as *Action Plan*).

draft. In particular, the draft does not contain a single rule or definition or principle which has been approved or mandated by a politically legitimated body at European or national level (save, of course, where it coincides with existing EU or national legislation). It may be that the DCFR at a later point in time will be carried over at least in part into a CFR, but that is a question for others to decide. This introduction merely sets out some considerations which might usefully be taken into account during the possible process of transformation.

5. ***About this introduction.*** This introduction explains the purposes pursued in preparing the DCFR and outlines its contents, underlying principles, coverage and structure. It elucidates the relationship between the DCFR and the publications which have already appeared or will appear in the course of the preparatory work. It sketches out how the DCFR might flow into the development of the CFR. Finally it looks towards the next steps. The introduction has been agreed with the Compilation and Redaction Team of both Groups.

The purposes of the DCFR

6. ***A possible model for a political CFR.*** As already indicated, this Draft is (among other things) a possible model for an actual or 'political' Common Frame of Reference (CFR). The DCFR presents a concrete text, hammered out in all its detail, to those who will be deciding whether or to what end or by what means there will be a CFR. At the time of writing it appears that none of these three questions is definitively resolved politically. Even if a CFR should emerge, it would not necessarily, of course, have the same coverage and contents as this DCFR. The question of which functions the DCFR might perform in the development of a CFR is considered below.
7. ***Legal science, research and education.*** The DCFR ought not to be regarded merely as a building block of a possible Common Frame of Reference. The DCFR would stand on its own and retain its significance even if a CFR were not to emerge. The DCFR is an academic text. It sets out the results of a large European research project and invites evaluation from that perspective. The full breadth of that scholarly endeavour will be apparent when the final edition is published. Independent of the fate of the CFR, it is hoped that the DCFR will promote knowledge of private law in the jurisdictions of the European Union, and in particular will help to show how much national private laws resemble one another and have provided mutual stimulus for development and indeed how much those laws may be regarded as regional manifestations of an overall common European legacy. The function of the DCFR is thus detached from that of the CFR in that it serves to sharpen awareness of the existence of a European private law and also (via the comparative notes that will appear in the final edition) to demonstrate the relatively small number of cases in which the different legal systems produce substantially different answers to common problems. The DCFR may furnish the notion of a European private law with a

new foundation which increases understanding for ‘the others’ and promotes collective deliberation on private law in Europe.

8. ***A possible source of inspiration.*** The drafters of the DCFR nurture the hope that it will be seen also outside the academic world as a text from which inspiration can be gained for suitable solutions for private law questions. Shortly after their publication the Principles of European Contract Law (PECL)², which the DCFR incorporates in a partly revised form, received the attention of many higher courts in Europe and of numerous official bodies charged with preparing the modernisation of the relevant national law of contract. It is possible that this development will continue in the context of the DCFR with repercussions for reform projects beyond as well as within the European Union. If the content of the DCFR convinces, it may contribute to a harmonious and informal Europeanisation of private law.

Contents of the DCFR

9. ***Principles, definitions and model rules.*** The DCFR contains ‘principles, definitions and model rules’. The title follows the scheme set out in the European Commission’s communications (referred to below in paragraph 59) and in our contract with the Commission. The notion of ‘definitions’ is reasonably clear. The notions of ‘principles’ and ‘model rules’, however, appear to overlap and require some explanation.
10. ***Meaning of ‘principles’.*** The European Commission’s communications concerning the CFR do not elaborate on the concept of ‘principles’. The word is susceptible to different interpretations. It is sometimes used, in the present context, as a synonym for rules which do not have the force of law. This is how it appears to be used, for example, in the ‘Principles of European Contract Law’ (PECL), which refer to themselves in Article 1:101(1) as ‘Principles ...

² *Ole Lando and Hugh Beale* (eds.), Principles of European Contract Law Parts I and II. Prepared by the Commission on European Contract Law (The Hague 1999); *Ole Lando, Eric Clive, André Prüm and Reinhard Zimmermann* (eds.), Principles of European Contract Law Part III (The Hague, London and Boston 2003). Translations are available in French (Principes du droit européen du contrat. Version française préparée par *Georges Rouhette*, avec le concours de *Isabelle de Lamberterie, Denis Tallon et Claude Witz*, Droit privé comparé et européen, vol. 2, Paris 2003); German (Grundregeln des Europäischen Vertragsrecht, Teile I und II, Kommission für Europäisches Vertragsrecht. Deutsche Ausgabe von *Christian von Bar und Reinhard Zimmermann*, München 2002; Grundregeln des Europäischen Vertragsrecht Teil III, Kommission für Europäisches Vertragsrecht. Deutsche Ausgabe von *Christian von Bar und Reinhard Zimmermann*, München 2005); Italian (Commissione per il Diritto Europeo dei Contratti. Principi di Diritto Europeo dei Contratti, Parte I & II, Edizione italiana a cura di *Carlo Castronovo*, Milano 2001; Commissione per il Diritto Europeo dei Contratti. Principi di Diritto Europeo dei Contratti, Parte III. Edizione italiana a cura di *Carlo Castronovo*, Milano 2005) and Spanish (Principios de Derecho Contractual Europeo, Partes I y II. Edición española a cargo de *Pilar Barres Bennloch, José Miguel Embid Irujo, Fernando Martínez Sanz*, Madrid 2003). *Matthias Storme* translated the articles of Parts I-III into Dutch (Tijdschrift voor privaatrecht 2005, 1181-1241); *M.-A. Zachariasiewicz and J. Beldowski* translated the PECL articles of Parts I and II (Kwartalnik Prawa Prywatnego 3/2004, 814-881) and *J. Beldowski and A. Koziol* the articles of Part III (Kwartalnik Prawa Prywatnego 3/2006, 847-859) into the Polish language. For further translations (sometimes of the articles of Books I and II only) see http://frontpage.cbs.dk/law/commission_on_european_contract_law/index.html.

intended to be applied as general *rules* of contract law in the European Union' (italics added). The word appears to be used in a similar sense in the UNIDROIT Principles of International Commercial Contracts. In this sense the DCFR could be said to consist of principles and definitions. It is essentially of the same nature as those other instruments in relation to which the word 'principles' has become familiar. The word 'principles' might also be reserved for those rules which are of a more general nature, such as those on freedom of contract or good faith. In this sense the DCFR, in its present form and without more, could be said to consist already of principles, model rules and definitions.

11. ***Underlying principles.*** The word 'principles' surfaces occasionally in the Commission communications mentioned already, but with the prefix 'fundamental' attached. That suggests that it may have been meant to denote essentially abstract basic values. The model rules of course build on such underlying principles in any event, whether they are stated or not. It would be possible to include in the DCFR a separate part which states these basic values and suggests factors that the legislator should bear in mind when seeking to strike a balance between them. For example, this part could be formulated as recitals, i.e. an introductory list of reasons for the essential substance of the following text. To give some idea of what this might look like, at least in relation to contract law, some possible fundamental principles are outlined at paragraphs 23-36, but without any claim to comprehensiveness. If this idea is thought to be useful, a fuller version could be developed at a later stage. It must be conceded, however, that, taken in isolation, such fundamental principles do not advance matters much at a practical level because of their high level of abstraction. Abstract principles tend to contradict one another. They always have to be weighed up against one another more exactly because only then are optimal outcomes assured. That task in turn, can only be accomplished with the help of well-formulated model rules. The fact that the word 'principles' might be construed quite naturally in this sense of 'fundamental principles' is a good reason for including 'model rules' in the title
12. ***Definitions.*** 'Definitions' have the function of suggestions for the development of a uniform European legal terminology. DCFR I.-1:103(1) ('The definitions in Annex 1 apply for all the purposes of these rules unless otherwise provided or the context otherwise requires') expressly incorporates the list of terminology in Annex 1 as part of the DCFR. This drafting technique, by which the definitions are set out in an appendage to the main text, was chosen in order to keep the first chapter short and to enable the list of terminology to be extended at any time without great editorial labour. The substance is partly distilled from the *acquis*, but predominantly derived from the model rules of the DCFR. If the definitions are essential for the model rules, it is also true that the model rules are essential for the definitions. There would be little value in a set of definitions which was internally incoherent. The definitions can be seen as components which can be used in the making of rules and sets of rules, but there is no point in having components which are incompatible with each other and cannot fit together. In contrast to a dictionary of terms assembled from disparate sources, the definitions in the Annex have been tested in the model rules and

revised and refined as the model rules have developed. Ultimately, useful definitions cannot be composed without model rules and useful model rules can hardly be drafted without definitions.

13. **Model rules.** The greatest part of the DCFR consists of ‘model rules’. The adjective ‘model’ indicates that the rules are not put forward as having any normative force but are soft law rules of the kind contained in the Principles of European Contract Law and similar publications. Whether particular rules might be used as a model for early legislation, for example, for the improvement of the internal coherence of the *acquis communautaire* (see further below, paragraph 61 ff) is for others to decide.
14. **Notes on national laws.** This version, as noted above, already contains explanatory comments on the Articles. A later version will contain extensive notes on the national laws of the Member States. The notes will reflect the legal position in the individual national legal systems and, so far as extant, the current Community law. How the notes were assembled is described in the section on the academic contributors and our funders.

Aims and underlying values

15. **Ongoing discussion on ‘fundamental principles’.** It is still an open question whether the CFR should be introduced by some ‘Fundamental Principles’ which reflect its underlying values, to assist the reader to understand the CFR more fully and to give general guidance to those who are using the CFR when preparing legislation. Several projects within the Network entrusted with preparatory works by the European Commission are dealing with the question of underlying values (see paragraph 76 below). It might therefore be useful at this point to sketch out some ideas on how the aims and underlying values of the DCFR, as it stands in this volume, could be expressed. The following remarks are based on an early draft presented to and discussed with a group of stakeholders in 2005³ and on several discussions among the members of the Compilation and Redaction Team.
16. **A matter of political standpoint.** To some extent the ‘Fundamental Principles’ that underlie the DCFR are a matter of interpretation and debate. Although it is clear that the DCFR does not perceive private law and in particular contract law only as the balancing of private law relations between equally strong natural and legal persons, different readers may have different interpretations of the extent to which it suggests the correction of market failures or contains elements of ‘social justice’ and welfarism, re-distribution of wealth and other forms of social engineering. Thus this statement of Fundamental Principles can be no more than the considered view of those who have contributed to this Introduction, and it is not yet complete.

³ Workshop organised by the European Commission on 6 June 2005 at Brussels; a short summary of the results can be found in the volume Principles of the Existing EC Contract Law (Acquis Principles), Volume Contract I — Pre-contractual Obligations, Conclusion of Contract, Unfair Terms. Prepared by the Research Group on the Existing EC Private Law (Acquis Group) (Sellier 2007), p. XI-XIII.

17. ***Function and purpose of 'fundamental principles'***. Private law and in particular contract law is one of those fields of law which are, or at least should be, based on and guided by deep-rooted underlying principles. Any statement of them must, in our view, give some practical guidance on how to read and to interpret the definitions and model rules contained in the CFR, and to reflect its theoretical underpinnings, including its underlying political, economical and social aims and values. These should be borne in mind by those using the CFR as a legislator's guide or tool-box.
18. ***'Fundamental principles' expressed as aims***. There are different ways of expressing such 'Fundamental Principles'. Options would be, among many others, a normative style setting out rights of European citizens or an analytical explanation of the underlying values of the Model Rules and Definitions contained in the text. As the Europeanisation of private law is an ongoing development and as the CFR exercise may be seen as part of this process it may be useful here to describe 'Fundamental Principles' as some core aims European private law, in particular contract law, should have.
19. ***Model of society and economic system***. The formulation of core aims and fundamental principles reveals the underlying model of society and of the economic system more directly than does the formulation of individual rules. It helps to clarify the position of the DCFR (and, eventually, the CFR) in the spectrum between free market and fair competition theories and more invasive approaches in favour of consumers, victims of discrimination, small and medium sized enterprises and the many other possibly weaker parties to contracts and members of society.
20. ***Community law and Member States laws as the measure***. As the DCFR is developed on the basis of comparative studies of Community law and the laws of the Member States, it has to reflect the underlying values to be found in the existing laws. These – or at any rate the balance struck between them – are not the same in each system. As far as there are differences between the underlying values in individual jurisdictions, or between the Member States' laws and EC law, the DCFR mediates between them and takes a balanced position.
21. ***Core aims of European private law***. Any attempt to work on principles of private law will at least have to deal with the following core aims and the values expressed in them:
 - Justice
 - Freedom
 - Protection of Human Rights
 - Economic Welfare
 - Solidarity and Social Responsibility.

In so far as it is the European Union which shapes private law, some specific aims may be added to that list, in particular:

- Promotion of the Internal Market
- Preservation of Cultural and Linguistic Plurality.

Moreover, if European private law is to be expressed in a set of Model Rules, some further, more ‘formal’ aims will have to be pursued:

- Rationality
- Legal Certainty
- Predictability
- Efficiency.

The words “at least” at the beginning of this paragraph are intended to indicate that there are other aims or principles which might be regarded as important, even if there might be argument as to whether they could be described as “core”. For example, the protection of a person’s reasonable reliance on another’s conduct might be considered an important aim. An important underlying principle in some areas of the law might be that people are generally responsible for risks which they themselves create.

22. ***Balancing conflicting aims and values.*** It is characteristic for such fundamental aims that they conflict with each other. For example, on occasion, justice in a particular case may have to make way for legal certainty, as happens under the rules of prescription. Freedom, in particular freedom of contract, may be limited for the sake of human rights if, for instance, rules on non-discrimination apply. Therefore the aims can never be pursued in a pure and rigid way. The underlying values of a private law system can only be discerned and described by explaining how such fundamental aims are balanced in the individual model rules.
23. ***Justice.*** Every model rule in this DCFR pursues the aim of reaching a just and fair solution for the situation to be regulated. The DCFR is particularly concerned to promote what Aristotle termed ‘corrective’ justice. This notion is fundamental to contract, non-contractual liability for damage and unjustified enrichment. General clauses like those on good faith and fair dealing (see paragraph 32 below) also serve the overarching aim of justice. The DCFR is less concerned with issues of ‘distributive justice’, but sometimes distributive or ‘welfarist’ concerns may also be reflected in the DCFR, for instance when it is decided that a consumer should always have certain rights.
24. ***Freedom, in particular freedom of contract.*** Contract is the basic legal instrument which enables natural and legal persons to enjoy the freedom to regulate their relations with each other by agreement. As a rule, natural and legal persons are free both to decide whether or not to contract and to agree on the terms of their contract because in some situations, freedom of contract, without more, leads to justice. If, for instance, the parties to a contract are fully informed and in an equal bargaining position when concluding it, the content of their agreement can be presumed to be in their interest and thus just. Therefore a contract will be enforced or recognised by law if it is based on the parties’ agreement and if there is no reason (such as an infringement of public policy) for the contract to be treated as invalid or set aside. But if one party to the contract is in a weaker position, it may not be just simply to enforce it. Thus a

contract concluded as the result of mistake or fraud, or which involves unfair exploitation or discrimination, can be set aside by the aggrieved party. However, restrictions on freedom of contract, whether by way of mandatory rules, avoidance of unfair contract terms or in any other form, should be imposed only if they can be justified in relation to certain situations or types of contract.

25. ***Restrictions on freedom to contract.*** Thus in general persons should remain free to contract or to refuse to contract with anyone else. However, this freedom may be qualified where it might result in unacceptable discrimination, for example discrimination on the grounds of gender, race or religion.
26. ***Restrictions on freedom to determine contents of contract.*** Similarly, restrictions on the parties' freedom to fix the terms of their contract may be justified even outside the classic cases of procedural unfairness such as mistake, fraud, duress and the exploitation of a party's circumstances to obtain an excessive advantage. Grounds on which restrictions might be justified include inequality of information (about either the facts, such as the characteristics of the goods or services to be supplied, or the terms of the contract, or both); and lack of bargaining power. Such problems are most common when a consumer is dealing with a business, but can also occur in contracts between businesses, particularly when one party is a small business that lacks expertise.
27. ***Minimum intervention.*** Even when some intervention can be justified on one of the grounds just mentioned, thought must be given to the form of intervention. Is the problem one that can be solved adequately by requiring one party to provide the other with information before the contract is made, with perhaps a right in the other party to avoid the contract if the information was not given? Or will problems persist even if consumers (for example) are 'informed', possibly because they will not be able to make effective use of the information? In such a case a mandatory rule giving the consumer certain rights (for example, that the goods must be of a certain quality) may be justified. In general terms, the interference with freedom of contract should be the minimum that will solve the problem while providing the other party (e.g. the business seller) with sufficient guidance to be able to arrange its affairs efficiently. (Sometimes it may be easier to have a simple rule rather than a standard that varies according to the circumstances of each case.) Similarly with contract terms: it must be asked whether it is necessary to make a particular term mandatory or whether a flexible test such as 'fairness' would suffice to protect the weaker party. A fairness test may allow certain terms to be used providing these are clearly brought home to the consumer or other party before the contract is made. The fairness test thus interferes less with the parties' freedom of contract than making a particular term mandatory would do.
28. ***Economic welfare.*** All areas of the law covered by the DCFR have the double aim of promoting general welfare by strengthening market forces and at the same time allowing individuals to increase their economic wealth. In many cases the DCFR is simply setting out rules that reflect an efficient solution - what the parties might have agreed but for the costs of trying to do so. This is most obviously true for many of the rules of contract law: these are simply

‘default rules’ to apply when the parties have not agreed anything on the point in question. The rules should produce efficient outcomes since that is presumably what the parties would have wanted. Many rules of the law on non-contractual liability for damage and even of unjustified enrichment law and the law on benevolent intervention in another’s affairs can be explained on the same basis; in any event, they should be efficient. The rules in the DCFR are in general intended to be such as will promote economic welfare; and this is a criterion against which any legislative intervention should be checked.

29. ***Interventions to promote efficiency.*** Economic welfare may sometimes be promoted by interference even when the parties have reached an agreement, if there is reason to think that because of some market failure (such as that caused by inequality of information) the agreement is less than fully efficient. Consumer protection rules, for example, can be seen not only as protective for the benefit of typically weaker parties but also as favourable for general welfare because they may lead to more competition and thus to a better functioning of markets. This holds true in particular for cases of the type mentioned above, where consumers’ lack of information about either the characteristics of the goods sold or the terms being offered leads to forms of market failure. Rules that, in relation to the making of a contract of a particular type or in a particular situation, require one party (typically a business) to provide the other (typically a consumer) with specified information about its nature, terms and effect, where such information is needed for a well-informed decision and is not otherwise readily available to that other party, can be justified as promoting efficiency in the relevant market. Indeed a legislator should consider whether this is the justification for the proposed intervention, or whether it is based on a welfarist notion that consumers simply should have the right in question. The answer to that question may influence the choice of the extent and form of intervention.
30. ***Protection of human rights.*** Private law must contribute to the protection of human rights and human dignity. In contract law and in pre-contractual relations, for instance, the rules on non-discrimination serve this purpose. The rules on non-contractual liability for damage also have the function of protecting human rights.
31. ***Solidarity and social responsibility.*** Private law must also demand a minimum of solidarity among the members of society and allow for altruistic and social activities. Examples of this function of private law may be seen in the provisions on good faith or in the Book on Benevolent Intervention. In the future, specific rules on contracts of donation may be needed to strengthen this aim. Within the field of contractual relationships, many think that solidarity is a fundamental principle. Thus the obligation to cooperate might well be justified on this ground as well as on the ground of promoting economic welfare.
32. ***Good faith.*** Equally, some see the promotion of good faith in contractual and other relationships as a fundamental principle, an end in itself. Others (particularly but not only, those from jurisdictions which give only very limited recognition to the principle of good faith) see it more as a legal technique for reaching fair and efficient results that might equally be reached by other, more fact-specific rules. Whatever the merits of this debate, the values that underlie

the notion – for example, the promotion of honest market practice, so that one party should not depart from good commercial practice to take unfair advantage of the other – may be called fundamental. These values are enshrined in the DCFR and legislators should bear them in mind – just as they should bear in mind that not all legal systems in the EU apply a general requirement of good faith, so that European legislation may need to include express provisions on the issue (see below, paragraph 72).

33. ***Contracts harmful to third persons and society in general.*** A further ground on which a contract may be invalidated, even though freely agreed between two equal parties, is that it (or more often the performance of the obligation under it) would have a seriously harmful effect on third persons or society. Thus contracts which are illegal or contrary to public policy in this sense (within the framework of the EU a common example is contracts which infringe the competition articles of the Treaty) are invalid. The DCFR does not spell out when a contract is contrary to public policy in this sense, because that is a matter for law outside the scope of the DCFR – the law of competition or the criminal law of the Member State where the relevant performance should take place. However the fact that a contract might harm third persons or society is clearly a ground on which the legislator should consider invalidating it, and the DCFR contains rules to that effect.
34. ***EU-specific aims.*** The DCFR is to be interpreted and applied in a manner consistent with the aims and principles on which not only the laws of the Member States but also the European Union are based, including the aim of establishing an area of freedom, security and justice, and the creation of an open internal market with free and fair competition and free movement of goods, persons, services and capital between Member States, and the protection of consumers and of others in need of protection. Cultural and linguistic plurality of Europe must be taken into account and preserved.
35. ***Rationality, legal certainty, predictability, efficiency.*** The underlying material aims of private law can only be reached if the applicable rules are rational and provide a measure of legal certainty, predictability and efficiency. To this end, unnecessary burdens must be avoided and smooth legal transactions fostered. In some cases individual rights may also be cut off by rules on time limits or parties to a contract may be protected not because they are individually but just typically in need of protection.

The coverage of the DCFR

36. ***Wider coverage than PECL.*** The coverage of the PECL was already quite wide. They had rules not only on the formation, validity, interpretation and contents of contracts and, by analogy, other juridical acts, but also on the performance of obligations resulting from them and on the remedies for non-performance of such obligations. Indeed the later Chapters had many rules applying to private law rights and obligations in general – for example, rules on a plurality of parties, on the assignment of rights to performance, on set-off and on prescription. To this extent the Principles went well beyond the law on contracts

as such. The DCFR continues this coverage but it goes further. It also covers (in Book IV) a series of model rules on so-called ‘specific contracts’ and the rights and obligations arising from them. For their field of application these latter rules expand and make more specific the general provisions (in Books I-III), deviate from them where the context so requires, or address matters not covered by them.

37. ***Non-contractual obligations.*** The DCFR also covers rights and obligations arising as the result of an unjustified enrichment, of damage caused to another and of benevolent intervention in another’s affairs. It thus embraces non-contractual obligations to a far greater extent than the PECL.
38. ***Matters of movable property law.*** In its full and final edition the DCFR will also cover some matters of movable property law, such as transfer of ownership, proprietary security, and trust law.
39. ***Matters excluded.*** DCFR I.–1:101(2) lists all matters which are excluded from its intended field of application.
40. ***Reasons for the approach adopted.*** The coverage of the DCFR is thus considerably broader than what the European Commission seems to have in mind for the coverage of the CFR (see paragraph 59 below). The ‘academic’ frame of reference is not subject to the constraints of the ‘political’ frame of reference. While the DCFR is linked to the CFR, it is conceived as an independent text. The research teams started in the tradition of the Commission on European Contract Law but with the aim of extending its coverage. When this work started there were no political discussions underway on the creation of a CFR of any kind, neither for contract law nor for any other part of the law. Our contract with the Research Directorate-General to receive funding under the sixth European Framework Programme on Research reflects this; it obliges us to address all the matters listed in paragraphs 36-38 above.
41. ***Contract law as part of private law.*** There are good reasons for not including *only* rules on general contract law in the DCFR. These general rules need to be tested to see whether or in what respect they have to be adjusted, amended and revised within the framework of the most important of the specific contracts. Nor can the DCFR contain only rules dealing with consumer contracts. The two Groups concur in the view that consumer law is not a self-standing area of private law. It consists of some deviations from the general principles of private law, but cannot be developed without them. And ‘private law’ for this purpose is not confined to the law on contract and contractual obligations. The correct dividing line between contract law (in this wide sense) and some other areas of law is in any event difficult to determine precisely.⁴ This DCFR therefore approaches the whole of the law of obligations as an organic entity or unit. In the final edition, some areas of property law with regard to movable property will be dealt with for more or less identical reasons and because some aspects of property law are of great relevance to the good functioning of the internal market.

⁴ See, in more detail, *von Bar and Drobnig* (eds.), *The Interaction of Contract Law and Tort and Property Law in Europe* (Munich 2004). This study was conducted on behalf of the European Commission.

Structure and language of the DCFR model rules

42. **Structure of the model rules.** The structure of the model rules was discussed on many occasions by the Study Group and the joint Compilation and Redaction Team. It was accepted from an early stage that the whole text would be divided into Books and that each Book would be subdivided into Chapters, Sections, Sub-sections (where appropriate) and Articles. In addition the Book on specific contracts and the rights and obligations arising from them was to be divided, because of its size, into Parts, each dealing with a particular type of contract (e.g. Book IV.A: Sale). All of this was relatively uncontroversial.
43. **Mode of numbering of the model rules.** The mode of numbering the model rules corresponds in its basic approach to the technique used in many of the newer European codifications. This too was chosen in order to enable necessary changes to be made and missing passages to be inserted into the DCFR later without more than minor editorial labour. (In this edition places where additions are expected are indicated by references such as ‘[in preparation]’) Books are numbered by capitalised Roman numerals, i.e., Book I (General provisions), Book II (Contracts and other juridical acts), etc. Only one Book (Book IV (Specific contracts and rights and obligations arising from them)) is divided into Parts: Part A (Sale), Part B (Lease of goods), etc. Chapters, sections (and also sub-sections) are numbered using Arabic numerals, e.g. chapter 5, section 2, sub-section 4, etc. Articles are then numbered sequentially within each Book (or Part) using Arabic numerals. The first Arabic digit, preceding the colon, is the number of the relevant chapter. The digit immediately following the colon is the number of the relevant section of that chapter. The remaining digits give the number of the Article within the section; sub-sections do not affect the numbering. For example, III.–3:509 (Effect on obligations under the contract) is the ninth Article in section 5 (Termination) of the third chapter (Remedies for non-performance) of the third book (Obligations and corresponding rights). One cannot see from the numbering, however, that in that section it is the first Article within sub-section 3 (Effects of termination).
44. **Ten books.** To a large extent the allocation of the subject matter to the different Books was also uncontroversial. It was readily agreed that Book I should be a short and general guide for the reader on how to use the whole text – dealing, for example, with its intended scope of application, how it should be interpreted and developed and where to find definitions of key terms. The later Books, from Book IV on, also gave rise to little difficulty so far as structure was concerned. There was discussion about the best order, but eventually it was settled that this would be Specific contracts and rights and obligations arising from them (Book IV); Benevolent intervention in another’s affairs (Book V); Non-contractual liability arising out of damage caused to another (Book VI); Unjustified enrichment (Book VII); Acquisition and loss of ownership in movables (Book VIII); Proprietary security rights in movable assets (Book IX) and Trusts (Book X). An important argument for putting the rules on specific contracts and their obligational effects in a Book of their own (subdivided into Parts) rather than in separate Books is that it would be easier in the future to add new Parts dealing

with other specific contracts without affecting the numbering of later Books and their contents. As said before, this interim edition does not yet contain Books VIII-X and still has some lacunae in Book IV.

45. **Books II and III.** The difficult decisions concerned Books II and III. There was never much doubt that these Books should cover the material in the existing Principles of European Contract Law (PECL, see para. 10 above and paras. 49-53 below) —general rules on contracts and other juridical acts, and general rules on contractual and (often) other obligations — but there was considerable difficulty in deciding how this material should be divided up between and within them and what they should be called. It was only after decisions were taken by the Co-ordinating Group on how the key terms ‘contract’ and ‘obligation’ would be used in the model rules, and after a special Structure Group was set up, that the way forward became clear. Book II would deal with contracts and other juridical acts (how they are formed, how they are interpreted, when they are invalid, how their content is determined and so on) while Book III would deal with obligations within the scope of the DCFR – both contractual and non-contractual – and corresponding rights.
46. **Juridical acts and obligations.** A feature of this division of material is a clear distinction between a contract seen as a type of agreement – a type of juridical act – and the legal relationship, usually involving reciprocal sets of obligations and rights, which results from it. Book II deals with contracts as juridical acts; Book III deals with the obligations and rights resulting from contracts seen as juridical acts, as well as with non-contractual obligations and rights. To this extent a structural division which is only implicit in the PECL is made explicit.
47. **Contractual and non-contractual obligations.** A further problem was how best to deal with contractual and non-contractual obligations within Book III. One technique which was tried was to deal first with contractual obligations and then to have a separate part on non-contractual obligations. However, this proved cumbersome and unsatisfactory. It involved either unnecessary repetition or extensive and detailed cross-references to earlier Articles. Either way the text was unattractive and heavy for the reader to use. In the end it was found that the best technique was to frame the Articles in Book III so far as possible in general terms so that they could apply to both contractual and non-contractual obligations. Where a particular Article applied only to contractual obligations (which was the exception rather than the rule) this could be clearly stated. This approach was expressly approved by a meeting of the Co-ordinating Group at Luzern in December 2006.
48. **Language.** The DCFR is being published first in English. This has been the working language for all the Groups responsible for formulating the model rules. However, for a substantial portion of the Books (or, in the case of Book IV, its Parts), teams have already composed a large number of translations into other languages. These will be published successively, first in the PEL series (see para. 54 below) and later separately for the DCFR. The Compilation and Redaction Team has tried to achieve not only a clear and coherent structure, but also a plain and clear wording. An attempt has been made to avoid technical terms from particular legal systems and to try to find, wherever possible,

descriptive language which can be readily translated without carrying unwanted baggage with it. After all, one of the overarching goals of the DCFR is to improve the accessibility and intelligibility of private law in Europe.

How the DCFR relates to PECL, the SGECC PEL series, the Acquis and the Insurance Contract Group series

49. ***Based in part on the PECL.*** In Books II and III the DCFR contains many rules derived from the Principles of European Contract Law (PECL). These rules have been adopted with the express agreement of the Commission on European Contract Law, whose successor group is the Study Group. Tables of derivations and destinations help the reader to trace PECL articles within the DCFR. However, the PECL could not simply be incorporated as they stood. Deviations were unavoidable in part due to the different structure and the different coverage of the DCFR and in part because the scope of the PECL needed to be broadened so as to embrace matters of consumer protection.
50. ***Deviations from PECL.*** A primary purpose of the DCFR is to try to develop clear and consistent concepts and terminology. In pursuit of this aim the Study Group gave much consideration to the most appropriate way of using terms like ‘contract’ and ‘obligation’, taking into account not only national systems, but also prevailing usage in European and international instruments dealing with private law topics. One reason for many of the drafting changes from the PECL is the clearer distinction now drawn (as noted above) between a contract (seen as a type of agreement or juridical act) and the relationship (usually consisting of reciprocal rights and obligations) to which it gives rise. This has a number of consequences throughout the text.
51. ***Examples.*** For example, it is not the contract which is performed. A contract is concluded: obligations are performed. Similarly, a contract is not terminated. It is the contractual relationship, or particular rights and obligations arising from it, which will be terminated. The new focus on rights and obligations in Book III also made possible the consistent use of ‘creditor’ and ‘debtor’ rather than terms like ‘aggrieved party’ and ‘other party’, which were commonly used in the PECL. The decision to use ‘obligation’ consistently as the counterpart of a right to performance also meant some drafting changes. The PECL sometimes used ‘duty’ in this sense and sometimes ‘obligation’. The need for clear concepts and terminology also meant more frequent references than in the PECL to juridical acts other than contracts. Examples of such juridical acts might be offers, acceptances, notices of termination, authorisations, guarantees, unilateral promises and so on. The PECL dealt with these by an Article (1:107) which applied the Principles to them ‘with appropriate modifications’. However, what modifications would be appropriate was not always apparent. It was therefore decided to deal separately with other juridical acts.
52. ***Input from stakeholders.*** Other changes in PECL Articles resulted from the input from stakeholders to the workshops held by the European Commission on selected topics. For example, the rules on representation were changed in several significant respects for this reason, as were the rules on pre-contractual

statements forming part of a contract, the rules on variation by a court of contractual rights and obligations on a change of circumstances and the rules on so-called ‘implied terms’ of a contract. Sometimes even the process of preparing for stakeholder meetings which were not, in the end, held led to proposals for changes in PECL which were eventually adopted. This was the case, for example, with the chapter on plurality of debtors and creditors, where academic criticism on one or two specific points also played a role.

53. ***Developments since the publication of the PECL.*** Finally, there were some specific Articles or groups of Articles which, in the light of recent developments or further work and thought, seemed to merit improvement. For example, the PECL rules on stipulations in favour of third parties, although a considerable achievement at the time, seemed in need of some expansion in the light of recent developments in national systems and international instruments. The detailed work which was done on the specific contracts in Book IV, and the rights and obligations resulting from them, sometimes suggested a need for some additions to, and changes in, the general rules in Books II and III. For example, it was found that it would be advantageous to have a general rule on ‘mixed contracts’ in Book II and a general rule on notifications of non-conformities in Book III. It was also found that the rules on ‘cure’ by a seller which were developed in the Sale Part of Book IV could usefully be generalised and placed in Book III. The work done on other later Books also sometimes fed back into Books II and III. For example, the work done on unjustified enrichment showed that rather more developed rules were needed on the restitutionary effects of terminated contractual relationships, while the work on the acquisition and loss of ownership in movables (and also on proprietary security rights in movable assets) fed back into the treatment of assignment in Book III. Although the general approach was to follow the PECL as much as possible there were, inevitably, a number of cases where it was found that small drafting changes, or some slight restructuring of an Article or group of Articles, or some slightly sharper distinctions, could increase clarity or consistency.
54. ***The PEL series.*** The Study Group began its labours in 1998. From the outset it was envisaged that at the appropriate time its results would be presented in an integrated complete edition, but it was only gradually that its structure took shape (see paras. 42-47 above). As a first step the tasks in the component parts of the project had to be organised and deliberated. The results are being published in a separate series, the ‘Principles of European Law’ (PEL). To date five volumes have appeared. They cover leases⁵, services⁶, commercial agency, franchise and distribution⁷, personal security contracts⁸, and benevolent

⁵ Principles of European Law. Study Group on a European Civil Code. Lease of Goods (PEL LG). Prepared by Kåre Lilleholt, Anders Victorin†, Andreas Fötschl, Berte-Elen R. Konow, Andreas Meidell, Amund Bjøranger Tørum (Sellier, Bruylant, Staempfli, Oxford University Press 2007).

⁶ Principles of European Law. Study Group on a European Civil Code. Service Contracts (PEL SC). Prepared by Maurits Barendrecht, Chris Jansen, Marco Loos, Andrea Pinna, Rui Casção, Stéphanie van Gulijk (Sellier, Bruylant, Staempfli, Oxford University Press 2006).

⁷ Principles of European Law. Study Group on a European Civil Code. Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC). Prepared by Martijn W. Hesselink, Jacobien W. Rutgers, Odavia Bueno Díaz, Manola Scotton, Muriel Veldmann (Sellier, Bruylant, Staempfli, Oxford University Press

interventions in another's affairs⁹. Further books will follow, in 2008 on sales, unjustified enrichment law and the law regarding non-contractual liability arising out of damage caused to another, and in 2009 on mandate and loan contracts, contracts of donation and all the subjects related to property law. The volumes published within the PEL series contain additional material which will not be reproduced in the full DCFR, namely the comparative introductions to the various Books, Parts and Chapters, and the translations of the model rules published within the PEL series.

55. ***Deviations from the PEL series.*** In some cases, however, the model rules which the reader encounters in this DCFR deviate from their equivalent published in the PEL series. There are several reasons for such changes. First, in drafting a self-standing set of model rules for a given subject (such as e.g. service contracts) it proved necessary to have much more repetition of rules which were already part of the PECL. Such repetitions became superfluous in an integrated DCFR text which states these rules already at a more general level (i.e. in Books II and III). The DCFR is therefore considerably shorter than it would have been had all PEL model rules been included as they stood.
56. ***Improvements.*** The second reason for changing some already published PEL model rules is that in some cases the Compilation and Redaction Team saw room for improvement at the stage of revising and editing for DCFR purposes. After consulting the authors of the relevant PEL book, the CRT submitted the redrafted rules to the Study Group's Co-ordinating Committee for approval, amendment or rejection. Resulting changes are in part limited to mere drafting, but occasionally go to substance. They are a consequence of the systematic revision of the model rules which commenced in 2006, the integration of ideas from others (including stakeholders) and the compilation of the list of terminology, which revealed some inconsistencies in the earlier texts. The DCFR in its full and final edition may reflect yet further refinements as compared with this interim outline edition.
57. ***The Acquis Principles (ACQP).*** The Research Group on the Existing EC Private Law, commonly called the Acquis Group, is also publishing its findings in a separate series.¹⁰ The Acquis Principles are an attempt to present and structure the bulky and rather incoherent patchwork of EC private law in a way that should allow the current state of its development to be made clear and relevant legislation and case law to be found easily. This also permits identification of shared features, contradictions and gaps in the Acquis. Thus, the ACQP may have a function for itself, namely as a source for the drafting, transposition and interpretation of EC law. Within the process of elaborating the DCFR, the Acquis Group and its output contribute to the task of ensuring that

2006).

⁸ Principles of European Law. Study Group on a European Civil Code. Personal Security (PEL Pers.Sec.). Prepared by Ulrich Drobnig (Sellier, Bruylant, Staempfli, Oxford University Press 2007).

⁹ Principles of European Law. Study Group on a European Civil Code. Benevolent Intervention in Another's Affairs (PEL Ben.Int.). Prepared by *Christian von Bar* (Sellier, Bruylant, Staempfli, Oxford University Press 2006).

¹⁰ See fn. 2 above; in preparation: Volume Contract II - Performance, Non-Performance, Remedies (Sellier 2008) and further volumes on specific contracts and extra-contractual matters.

the existing EC law is appropriately reflected. The ACQP are consequently one of the sources from which the Compilation and Redaction Team has drawn.

58. ***Principles of European Insurance Contract Law.*** The CoPECL network of researchers established under the sixth framework programme for research (see below: academic contributors and funders) also includes the ‘Project Group Restatement of European Insurance Contract Law (Insurance Group)’. That body is delivering its ‘Principles of European Insurance Contract Law’ to the European Commission contemporaneously with our submission of this provisional DCFR. It is not yet conclusively settled whether and, if so, how that text will be integrated into Book IV of the full DCFR. An appropriate slot for incorporation of that material has been reserved in case it is needed.

How the DCFR may be used as preparatory work for the CFR

59. ***Announcements by the Commission.*** The European Commission’s ‘Action Plan on A More Coherent European Contract Law’ of January 2003¹¹ called for comments on three proposed measures: increasing the coherence of the *acquis communautaire*, the promotion of the elaboration of EU-wide standard contract terms¹², and further examination of whether there is a need for a measure that is not limited to particular sectors, such as an ‘optional instrument.’ Its principal proposal for improvement was to develop a Common Frame of Reference (CFR) which could then be used by the Commission in reviewing the existing *acquis* and drafting new legislation.¹³ In October 2004 the Commission published a further paper, ‘European Contract Law and the revision of the *acquis*: the way forward’.¹⁴ This proposed that the CFR should provide ‘fundamental principles, definitions and model rules’ which could assist in the improvement of the existing *acquis communautaire*, and which might form the basis of an optional instrument if it were decided to create one. Model rules would form the bulk of the CFR¹⁵, its main purpose being to serve as a kind of a legislators’ guide or ‘tool box’. Meanwhile a parallel review of eight consumer Directives¹⁶ would be carried out. Members of the *Acquis Group* were involved in this review.¹⁷ In 2007 the European Commission published a Green Paper on the review of the consumer *acquis*.¹⁸ This DCFR responds to these

¹¹ COM (2003) final, OJ C 63/1 (referred to here as *Action Plan*).

¹² This aspect of the plan is not being taken forward. See Commission of the European Communities. First Progress Report on The Common Frame of Reference, COM (2005), 456 final, p. 10.

¹³ *Action Plan* para. 72.

¹⁴ Communication from the Commission to the European Parliament and the Council, COM (2004) 651 final, 11 October 2004 (referred to as *Way Forward*).

¹⁵ *Way Forward* para. 3.1.3, p. 11.

¹⁶ Directives 85/577, 90/314, 93/13, 94/47, 97/7, 98/6; 98/27, 99/44. See *Way Forward* para. 2.1.1.

¹⁷ See *Schulte-Nölke/Twigg-Flesner/Ebers* (eds), *EC Consumer Law Compendium, Comparative Analysis*, 2007, to be published in book form and in the meantime available at (http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/comp_analysis_en.pdf).

¹⁸ Green Paper on the Review of the Consumer *Acquis*, COM(2006) 744 final of 8 February 2007 (http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/green-paper_cons_acquis_en.pdf).

announcements by the Commission and contains proposals for the principles, definitions and model rules mentioned in them.

60. **Purposes of the CFR.** It remains to be seen what purposes the CFR may be called upon to serve. Some indication may be obtained from the expression ‘principles, definitions and model rules’ itself. Other indications can be obtained from the Commission’s papers on this subject. These, and their implications for the coverage of the DCFR, will now be explored.
61. **Green Paper on the Review of the Consumer Acquis.** The Commission’s Green Paper on the Review of the Consumer Acquis¹⁹ asked questions at a number of different levels: for example, whether full harmonisation is desirable²⁰, whether there should be a horizontal instrument²¹, and whether various additional matters should be dealt with by the Consumer Sales Directive²². It is possible that other Directives will also be revised, for example those relating to the provision of information to buyers of financial services. In the longer term, there may be proposals for further harmonisation measures in sectors where there still appears to be a need for consumer protection (e.g. contracts for services or personal security) or where the differences between the laws of the Member States appear to cause difficulties for the internal market (e.g. insurance or security over movable property).
62. **Improving the existing and future acquis: model rules.** The DCFR is intended to help in the process of improving the existing *acquis* and in drafting any future EU legislation in the field of private law. By teasing out and stating clearly the principles that underlie the existing *acquis*, the DCFR can show how the existing Directives can be made more consistent and how various sectoral provisions might be given a wider application, so as to eliminate current gaps and overlaps — the ‘horizontal approach’ referred to in the Green Paper. The DCFR should also identify improvements in substance that might be considered. The research preparing the DCFR ‘will aim to identify best solutions, taking into account national contract laws (both case law and established practice), the EC *acquis* and relevant international instruments, particularly the UN Convention on Contracts for the International Sale of Goods of 1980’.²³ The DCFR therefore provides recommendations, based on extensive comparative research and careful analysis, of what should be considered if legislators are minded to alter or add to EU legislation. This process of considering ‘model rules’ has begun even before the DCFR is complete. Many of the questions posed in the Green Paper draw on texts from the drafts which researchers presented to stakeholder workshops during 2006. However, the DCFR does not identify particular rules that are put forward as proposals for immediate legislation. Rather the aim is to provide rules from which the legislator may draw inspiration.

¹⁹ See previous footnote.

²⁰ Question A3, p. 15.

²¹ Question A2, p. 14.

²² Directive 1999/44/EC. See questions H1-M3, pp. 24-32.

²³ *Way Forward* para 3.1.3.

63. ***Improving the acquis: developing a coherent terminology.*** Directives frequently employ legal terminology and concepts which they do not define.²⁴ The classic example, seemingly referred to in the Commission's papers, is the *Simone Leitner* case²⁵, but there are many others. A CFR which provides definitions of these legal terms and concepts would be useful for questions of interpretation of this kind, particularly if it were adopted by the European institutions — for example, as a guide for legislative drafting.²⁶ It would be presumed that the word or concept contained in a Directive was used in the sense in which it is used in the CFR unless the Directive stated otherwise. National legislators seeking to implement the Directive, and national courts faced with interpreting the implementing legislation, would be able to consult the CFR to see what was meant. Moreover, if comparative notes on the Articles are included, as they will be in the final version of the DCFR, the notes will often provide useful background information on how national laws currently deal with the relevant questions.
64. ***No functional terminology list without rules.*** As said before, it is, however, impossible to draft a functional list of terminology without a set of model rules behind it, and vice versa. That in turn makes it desirable to consider a rather wide coverage of the CFR. For example, it would be very difficult to develop a list of key notions of the law on contract and contractual obligations (such as conduct, creditor, damage, indemnify, loss, intention, negligence etc.), without a sufficient awareness of the fact that many of these notions also play a role in the area of non-contractual obligations.
65. ***Improving the acquis: principles.*** It has already been noted that the word 'principles' may in the present context be synonymous with 'model rules', or those model rules which are of a more general nature, or may be understood in the sense of a statement of the values that underlie the rules of the CFR and general guidance to legislators on the balance that may need to be struck between competing values. Paragraphs 14-35 above contain an indication of how such a statement might be developed if it is required.
66. ***Coverage of the CFR.*** The purposes to be served by the DCFR have a direct bearing on its coverage. As explained in paras. 36-41 above, the coverage of the DCFR goes well beyond the coverage of the CFR as contemplated by the Commission in its communications (whereas the European Parliament in earlier resolutions envisaged for the CFR more or less the same coverage as this

²⁴ In the CFR workshops on the consumer *acquis*, texts providing definitions of concepts used or presupposed in the EU *acquis* were referred to as 'directly relevant' material. See Second Progress Report on the Common Frame of Reference, COM (2007) 447 final, p. 2.

²⁵ Case C-168/00 *Simone Leitner v TUI Deutschland* [2002] ECR I-2631. The ECJ had to decide whether the damages to which a consumer was entitled under the provisions of the Package Travel Directive must include compensation for non-economic loss suffered when the holiday was not as promised. This head of damages is recognised by many national laws, but was not recognised by Austrian law. The ECJ held that 'damage' in the Directive must be given an autonomous, 'European' legal meaning – and in this context 'damage' is to be interpreted as including non-economic loss.

²⁶ In the absence of any formal arrangement, legislators could achieve much the same result for individual legislative measures by stating in the recitals that the measure should be interpreted in accordance with the CFR.

DCFR²⁷). Today, the coverage of the CFR still seems to be an open question. How far should it reach if it is to be effective as a legislators' guide or 'tool box'? How may this DCFR be used if it is decided that the coverage of the CFR will be narrower (or even much narrower) than the coverage of the DCFR? The following aspects would seem to be worthy of being taken into consideration when making the relevant political decisions.

67. **Consumer law.** It seems clear that the CFR must at any rate cover the fields of application of the existing Directives that are under review, and any others likely to be reviewed in the foreseeable future. Thus all consumer law should be included, and probably all contracts and contractual relationships that are the subject of existing Directives affecting questions of private law, since these may also be reviewed at some stage.
68. **Revision of the *acquis* and further harmonisation measures.** Secondly, the CFR should cover any field in which revision of the *acquis* or further harmonisation measures is being considered. This includes both areas currently under review (e.g. sales, and also leasing which is discussed in the Green Paper on revision of the consumer *acquis*²⁸) and also areas where harmonisation is being considered, even if there are no immediate proposals for new legislation. Thus contracts for services should be covered, and also security over movable property, where divergences of laws cause serious problems. The same holds true for insurance contracts.²⁹
69. **Terms and concepts referred to in Directives.** Thirdly, in order to provide the definitions that are wanted, the CFR must cover many terms and concepts that are referred to in Directives without being defined.³⁰ In practice this includes almost all of the general law on contract and contractual obligations. There are so few topics that are not at some point referred to in the *acquis*, or at least presupposed by it, that it is simpler to include all of this general law than to work out what few topics can be omitted. It is not only contract law terminology in the strict sense which is referred to, however, and certainly not just contract law which is presupposed in EU instruments. For example, consumer Directives frequently presuppose rules on unjustified enrichment law; and Directives on pre-contractual information refer to or presuppose rules that in many systems are classified as rules of non-contractual liability for damage, i.e. delict or tort. It is thus useful to provide definitions of terms and model rules in these fields – not because they are likely to be subjected to regulation or harmonisation by European legislation in the foreseeable future, but because existing European legislation already builds on assumptions that the laws of the Member States have relevant rules and provide appropriate remedies. Whether they do so in ways that fit well with the European legislation, actual or proposed, is another matter. It is for the European institutions to decide what might be needed or

²⁷ European Parliament, Resolution of 15 November 2001, OJ C 140E of 13 June 2002, p. 538.

²⁸ See footnote 19.

²⁹ See *Way Forward* para. 3.1.3 and Annex I.

³⁰ At the workshop on the possible structure of the CFR, 'there was an emerging consensus that the CFR should contain the topics directly related to the existing EU contract law *acquis* in combination with general contract law issues which are relevant for the *acquis*': Commission of the European Communities. Second Progress Report on the Common Frame of Reference, COM (2007) 447 final, pp. 8-9.

might be useful. What seems clear is that it is not easy to identify in advance topics which will never be wanted.

70. ***When in doubt, topics should be included.*** There are good arguments for the view that in case of doubt, topics should be included. Excluding too many topics will result in the CFR being a fragmented patchwork, thus replicating a major fault in existing EU legislation on a larger scale. Nor can there be any harm in a broad CFR. It is not legislation, nor even a proposal for legislation. It merely provides language and definitions for use, when needed, in the closely targeted legislation that is, and will probably remain, characteristic of European Union private law.
71. ***Essential background information.*** There is a further way in which the CFR would be valuable as a legislators' guide, and it has been prepared with a view to that possible purpose. If EU legislation is to fit harmoniously with the laws of the Member States, and in particular if it is neither to leave unintended gaps nor to be more invasive than is necessary, the legislator needs to have accurate information about the different laws in the various Member States. The national notes to be included in the final version of the DCFR could be useful in this respect but would, of course, have to be frequently updated if this purpose is to be served on a continuing basis.
72. ***Good faith as an example.*** The principle of good faith can serve as an example. In many laws the principle is accepted as fundamental, but it is not accorded the same recognition in the laws of all the Member States – in particular, it is not recognised as a general rule of direct application in the Common Law jurisdictions. It is true that even the Common Law systems contain many particular rules that seem to be functionally equivalent to good faith, in the sense that they are aimed at preventing the parties from acting in ways that are incompatible with good faith, but there is no *general* rule. So the European legislator cannot assume that whatever requirements it chooses to impose on consumer contracts in order to protect consumers will always be supplemented by a general requirement that the parties act in good faith. If it wants a general requirement to apply in the particular context, even in the Common Law jurisdictions, the legislator will have to incorporate the requirement into the Directive in express words – as of course it did with the Directive on Unfair Terms in Consumer Contracts.³¹ Alternatively, it will need to insert into the Directive specific provisions to achieve the results that in other jurisdictions would be reached by the application of the principle of good faith. In drafting or revising a Directive dealing with pre-contractual information, legislators will want to know what they need to deal with and what is already adequately covered, and covered in a reasonably harmonious way, by the law of all Member States. Thus general principles on mistake, fraud and provision of incorrect information form essential background to the consumer *acquis* on pre-contractual information. In this sense, even a 'legislators' guide' needs statements of the common principles found in the different laws, and a note of the variations. It needs information about what is in the existing laws and what

³¹ Council Directive 93/13/EEC, art. 3(1).

can be omitted from the *acquis* because, in one form or another, all Member States already have it.

73. ***Presupposed rules of national law.*** The point is that a Directive normally presupposes the existence of certain rules in national law. For example, when a consumer exercises a right to withdraw from a contract, questions of liability in restitution are normally left to national law. It may be argued that information about the law that is presupposed is more than ‘essential background’. The Commission’s Second Progress Report describes it as ‘directly relevant’.³² Whatever the correct classification, this information is clearly important. Put simply, European legislators need to know what is a problem in terms of national laws and what is not. This is a further reason why the DCFR will have a wide coverage and why the final (and full) DCFR will contain extensive notes, comparing the rules stated to the various national laws.
74. ***DCFR not structured on an ‘everything or nothing’ basis.*** The DCFR is, so far as possible, structured in such a way that the political institutions, if they wish to proceed with an official Common Frame of Reference on the basis of some of its proposals, can sever certain parts of it and leave them to a later stage of deliberation or just to general discussion amongst academics. In other words, the DCFR is carefully not structured on an ‘everything or nothing’ basis; perhaps not every detail can be cherry-picked intact, but in any event larger areas could be taken up without any need to accept the entirety. For example, the reader will soon see that the provisions of Book III are directly applicable to contractual rights and obligations; it is simply that they also apply to non-contractual rights and obligations. Were the Commission to decide that the CFR should deal only with the former, it would be a quick and simple task to adjust the draft to apply only to contractual rights and obligations. We would not advise this, however, for reasons explained earlier. It would create the appearance of a gulf between contractual and other obligations that does not in fact exist in the laws of Member States, and it would put the coherence of the structure at risk.
75. ***The CFR as the basis for an optional instrument.*** What has been said so far about the purposes of the CFR relates to its function as a legislators’ guide or toolbox. It is still unclear whether or not the CFR, or parts of it, might at a later stage be used as the basis for an optional instrument, i.e. as the basis for an additional set of legal rules which parties might choose to govern their mutual rights and obligations. In the view of the two Groups such an optional instrument would open attractive perspectives, not least for consumer transactions. A more detailed discussion of this issue, however, seems premature at this stage. It suffices to say that this DCFR is consciously drafted in a way that, given the political will, would allow progress to be made towards the creation of such an optional instrument.

³² Loc. cit. (fn. 31 above) p. 2.

Next steps

76. **Review of the DCFR.** In the time remaining until completion of the final version of the DCFR the model rules in this version will be reviewed once more to check their correctness, acceptability and coherence. Criticism and comments are most welcome. Likewise, the impact of the work of the Evaluative Groups³³ which are integrated into the network of excellence has yet to be assessed; their results are not yet available in published form and could therefore only be taken account of until now on the basis of their broad tenor. Part of this concomitant evaluation is an economic impact assessment, carried out by the Research Group on the Economic Assessment of Contract Law Rules, organised by the Tilburg Law and Economics Centre), an analysis of the philosophical underpinnings, undertaken by the Association Henri Capitant together with the Société de Législation Comparée and the Conseil Supérieur du Notariat; case assessments regarding the applicability of the principles made by the Common Core Group; and a case law database elaborated by a team of the University Paris-Sud.
77. **Outstanding matters.** Furthermore, some still outstanding matters need to be addressed. This relates not only to the missing Parts of Book IV and Books VIII-X, but also to the possible integration of new EC legislation (such as the new Services Directive³⁴ and the forthcoming Consumer Credit Directive³⁵) into the DCFR.
78. **Square brackets.** The square brackets in II.–9:404 (Meaning of unfair in contracts between a business and a consumer) are there because the Study Group and the Acquis Group were unable to reach agreement on whether the words in square brackets should or should not be included. The Acquis Group wished these words to be in the text. The Study Group considered that they should be excluded. The square brackets in III.–5:108 (Assignability: effect of contractual prohibition) paragraph (5) indicate that there is an ongoing discussion about the scope of this paragraph which there has not been time to resolve.
79. **Full and final DCFR.** The full and final version of the DCFR is to be submitted to the European Commission at the end of December 2008. It will subsequently be reproduced in book form as a larger publication. We aim to publish at the same time a second outline edition containing Articles only, without comments or national notes.

December 2007

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³³ For more information see the homepage of the Network of Excellence: www.copec.org.

³⁴ Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market

³⁵ Political agreement on the new Consumer Credit Directive reached in Council on 21 May 2007; Common Position adopted on 20 September 2007; see further the Communication of the European Commission of 21 September 2007 COM (2007) 546 final.

ACADEMIC CONTRIBUTORS AND FUNDERS

The pan-European teams

As indicated already, this first edition of the DCFR is the result of more than 25 years' collaboration of jurists from all jurisdictions of the present Member States within the European Union. It began in 1982 with the constitution of the Commission on European Contract Law (CECL) and was furthered by the establishment of the Study Group in 1998 and the Acquis Group in 2002. From 2005 the Study Group, Acquis Group and Insurance Contract Group formed the so-called. "drafting teams" of the CoPECL network. The following DCFR is the result of the work of the Study Group, Acquis Group und CECL.

The Study Group on a European Civil Code

The Study Group has had the benefit of Working (or Research) Teams – groups of younger legal scholars under the supervision of a senior member of the Group (a Team Leader) – which undertook the basic comparative legal research, developed the drafts for discussion and assembled the extensive material required for the notes. Furthermore, to each Working Team was allocated a consultative body – an Advisory Council. These bodies – deliberately kept small in the interests of efficiency – were formed from leading experts in the relevant field of law who are representative of the major European legal systems. The proposals drafted by the Working Teams and critically scrutinised and improved in a series of meetings by the respective Advisory Council were submitted for discussion on a revolving basis to the actual decision-making body of the Study Group on a European Civil Code, the Co-ordinating Group. Until June 2004 the Co-ordinating Group consisted of representatives from all the jurisdictions belonging to the EU immediately prior to its enlargement in Spring 2004 and in addition legal scholars from Estonia, Hungary, Norway, Poland, Slovenia and Switzerland. Representatives from the Czech Republic, Malta, Latvia, Lithuania and Slovakia joined us after the June 2004 meeting in Warsaw and representatives from Bulgaria and Romania after the December 2006 meeting in Lucerne. Besides its permanent members, other participants in the Co-ordinating Group with voting rights included all the Team Leaders and – when the relevant material was up for discussion – the members of the Advisory Council concerned. The results of the deliberations during the week-long sitting of the Co-ordinating Group were incorporated into the text of the Articles and the commentaries which returned to the agenda for the next meeting of the Co-ordinating Group (or the next but one depending on the work load of the Group and the Team affected). Each part of the project was the subject of debate on manifold occasions, some stretching over many years. Where a unanimous opinion could not be achieved, majority votes were taken.

Its Co-ordinating Group

The Study Group's Co-ordinating Group has (or had) the following members: Professor *Guido Alpa* (Genua/Rome, until May 2005), Professor *Christian von Bar* (Osnabrück; chairman), Professor *Maurits Barendrecht* (Tilburg, until May 2005), Professor *Hugh Beale* (Warwick), Dr. *Mircea-Dan Bocsan* (Cluj, since June 2007), Professor *Michael Joachim Bonell* (Rome), Professor *Mifsud G. Bonnici* (Valetta, since December 2004), Professor *Carlo Castronovo* (Milan), Professor *Eric Clive* (Edinburgh), Professor *Eugenia Dacoronia* (Athens), Professor *Ulrich Drobnig* (Hamburg), Professor *Bénédicte Fauvarque-Cosson*

(Paris), Professor *Marcel Fontaine* (Leuven, until December 2003), Professor *Andreas Furrer* (Lucerne, since December 2003), Professor *Júlio Manuel Vieira Gomes* (Oporto), Professor *Viggo Hagstrøm* (Oslo, since June 2002), Justitierådet Professor *Torgny Håstad* (Stockholm), Professor *Johnny Herre* (Stockholm), Professor *Martijn Hesselink* (Amsterdam), Professor *Ewoud Hondius* (Utrecht, until May 2005), Professor *Jérôme Huet* (Paris), Professor *Giovanni Iudica* (Milan, since June 2004), Dr. *Monika Jurčova* (Trnava, since June 2006), Professor *Konstantinos Kerameus* (Athens), Professor *Ole Lando* (Copenhagen), Professor *Kåre Lilleholt* (Bergen, since June 2003), Professor *Marco Loos* (Amsterdam); Professor *Brigitta Lurger* (Graz), Professor *Hector MacQueen* (Edinburgh), Professor *Ewan McKendrick* (Oxford), Professor *Valentinas Mikelenas* (Vilnius, since December 2004), Professor *Eoin O'Dell* (Dublin, until June 2006), Professor *Edgar du Perron* (Amsterdam), Professor *Denis Philippe* (Leuven, since June 2004), Professor *Jerzy Rajski* (Warsaw), Professor *Christina Ramberg* (Gothenburg), Judge Professor *Encarna Roca y Trias* (Madrid/Barcelona), Professor *Peter Schlechtriem*† (Freiburg i. Br.), Professor *Martin Schmidt-Kessel* (Osnabrück, since December 2004), Professor *Jorge Sinde Monteiro* (Coimbra, until December 2004), Professor *Lena Sisula-Tulokas* (Helsinki), Professor *Sophie Stijns* (Leuven), Professor *Matthias Storme* (Leuven), Dr. *Stephen Swann* (Osnabrück), Professor *Christian Takoff* (Sofia, since June 2007), Professor *Luboš Tichý* (Prague, since June 2005), Professor *Verica Trstenjak* (Maribor, until December 2006), Professor *Vibe Ulfbeck* (Copenhagen, since June 2006), Professor *Paul Varul* (Tartu, since June 2003), Professor *Lajos Vékás* (Budapest), Professor *Anna Veneziano* (Teramo).

The Study Group's Working Teams

Permanent working teams were and continue to be based in various European universities and research institutions. The teams' former and present "junior members" conducted research into basically three main areas of private law: contract law, the law of extra-contractual obligations, and property law. They sometimes stayed for one or two years only, but often considerably longer in order additionally to pursue their own research projects. The meetings of the Co-ordinating Group and of numerous Advisory Councils were organised from Osnabrück, in conjunction with the relevant host, by *Ina El Kobbia*.

The members of the Working Teams were: *Begoña Alfonso de la Riva*, *Georgios Arnokouros*, Dr. *Erwin Beysen*, *Christopher Bisping*, *Ole Böger*, *Manuel Braga*, Dr. *Odavia Bueno Díaz*, Dr. *Sandie Calme*, Dr. *Rui Cascaõ*, *Cristiana Cicoria*, *Martine Costa*, *Inês Couto Guedes*, Dr. *John Dickie*, Dr. *Evlalia Eleftheriadou*, Dr. *Wolfgang Faber*, *Silvia Fedrizzi*, Dr. *Francesca Fiorentini*, Dr. *Andreas Fötschl*, *Laetitia Franck*, Dr. *Caterina Gozzi*, *Allessio Greco*, *Lodewijk Gualthérie van Weezel*, *Stéphanie van Gulijk*, *Judith Hauck*, Dr. *Lars Haverkamp*, *Annamaria Herpai*, Dr. *Viola Heutger*, Dr. *Matthias Hünert*, Professor *Chris Jansen*, Dr. *Christoph Jeloschek*, *Menelaos Karpathakis*, Dr. *Stefan Kettler*, *Ina El Kobbia*, Dr. *Berte-Elen R. Konow*, *Rosalie Koolhoven*, *Caroline Lebon*, *Jacek Lehmann*, *Martin Lilja*, *Roland Lohnert*, *Birte Lorenzen*, Dr. *María Ángeles*, *Martín Vida*, *Almudena de la Mata Muñoz*, *Pádraic McCannon*, Dr. *Mary-Rose McGuire*, *Paul McKane*, *José Carlos de Medeiros Nóbrega*, Dr. *Andreas Meidell*, *Philip Mielnicki*, *Anastasios Moraitis*, *Sandra Müller*, *Franz Nieper*, *Teresa Pereira*, Dr. *Andrea Pinna*, *Sandra Rohlfing*, Dr. *Jacobien W. Rutgers*, *Johan Sandstedt*, *Marta dos Santos Silva*, Dr. *Mårten Schultz*, *Manola Scotton*†, *Frank Seidel*, *Susan Singleton*, Dr. *Hanna Sivesand*, Dr. *Malene Stein Poulsen*, *Dimitar Stoimenov*, Dr. *Stephen Swann*, *Ferenc Szilágyi*, Dr. *Amund Bjøranger Tørum*, *Muriel Veldman*, *Carles Vendrell Cervantes*, *Ernest Weiker*, *Aneta Wiewiorowska*, *Bastian Willers*.

The Study Group's Advisory Councils

The members of the Advisory Councils to the permanent working teams (who not infrequently served more than one team or performed other functions besides) were: Professor *John W. Blackie* (Strathclyde), Professor *Michael G. Bridge* (London), Professor *Angel Carrasco* (Toledo), Professor *Carlo Castronovo* (Milan), Professor *Eric Clive* (Edinburgh), Professor *Pierre Crocq* (Paris); Professor *Eugenia Dacoronia* (Athens), Professor *Bénédicte Fauvarque-Cosson* (Paris), Professor *Jacques Ghestin* (Paris), Professor *Júlio Manuel Vieira Gomes* (Oporto), Professor *Helmut Grothe* (Berlin), Justitierådet Professor *Torgny Håstad* (Stockholm), Professor *Johnny Herre* (Stockholm), Professor *Jérôme Huet* (Paris), Professor *Giovanni Iudica* (Milan), Dr. *Monika Jurčova* (Trnava), Professor *Jan Kleineman* (Stockholm), Professor *Irene Kull* (Tartu), Professor *Denis Mazeaud* (Paris), Professor *Hector MacQueen* (Edinburgh), Professor *Ewan McKendrick* (Oxford), Professor *Graham Moffat* (Warwick), Professor *Andrea Nicolussi* (Milan), Professor *Eoin O'Dell* (Dublin), Professor *Guillermo Palao Moreno* (Valencia), Professor *Edgar du Perron* (Amsterdam), Professor *Maria A.L. Puelinckx-van Coene* (Antwerp), Professor *Philippe Rémy* (Poitiers), Professor *Peter Schlechtriem*† (Freiburg i. Br.), Professor *Martin Schmidt-Kessel* (Osnabrück), Dr. *Kristina Siig* (Århus), Professor *Matthias Storme* (Leuven), Dr. *Stephen Swann* (Osnabrück), Professor *Stefano Troiano* (Verona), Professor *Antoni Vaquer Aloy* (Lleida), Professor *Anna Veneziano* (Rome), Professor *Alain Verbeke* (Leuven and Tilburg), Professor *Anders Victorin*† (Stockholm), Professor *Sarah Worthington* (London).

The Acquis Group

The Acquis Group texts result from a drafting process which involved individual Drafting Teams, the Redaction Committee, the Terminology Group, and the Plenary Meeting. The Drafting Teams produced a first draft of rules with comments for their topic or area on the basis of a survey of existing EC law. The drafts were then passed on to the Redaction Committee and to the Terminology Group which formulated proposals for making the various drafts by different teams dovetail with each other, also with a view towards harmonising the use of terminology and improving the language and consistency of drafts. All draft rules were debated several times at, and finally adopted by, Plenary Meetings of the Acquis Group, which met twice a year. Several drafts which were adopted by Plenary Meetings (in particular those on pre-contractual information duties, unfair terms and withdrawal) were subsequently presented and discussed at CFR-Net Stakeholder Meetings. Their comments were considered within a second cycle of drafting and consolidation of the Acquis Principles.

The following members of the Acquis Group took part in the *Plenary Meetings*: Professor *Gianmaria Ajani* (Torino, speaker), Professor *Esther Arroyo i Amayuelas* (Barcelona), Professor *Carole Aubert de Vincelles* (Lyon), Dr. *Guillaume Busseuil* (Paris), Dr. *Simon Chardenoux* (Paris), Professor *Giuditta Cordero Moss* (Oslo), Professor *Gerhard Dannemann* (Berlin), Dr. *Martin Ebers* (Barcelona), Professor *Silvia Ferreri* (Torino), Professor *Lars Gorton* (Lund), Professor *Michele Graziadei* (Torino), Professor *Hans Christoph Grigoleit* (Regensburg), Professor *Luc Grynbaum* (Paris), Professor *Geraint Howells* (Lancaster), Professor *Tsvetana Kamenova* (Sofia), Professor *Konstantinos Kerameus* (Athens), Professor *Stefan Leible* (Bayreuth), Professor *Eva Lindell-Frantz* (Lund), Dr. hab. *Piotr Machnikowski* (Wrocław), Professor *Ulrich Magnus* (Hamburg), Professor *Peter Møgelvang-Hansen* (Copenhagen), Professor *Susana Navas Navarro* (Barcelona), Dr. *Paolisa Nebbia* (Oxford), Dr. *Barbara Pasa* (Torino), Professor *Thomas Pfeiffer* (Heidelberg), Professor *António Pinto Monteiro* (Coimbra), Professor *Jerzy Pisulinski* (Kraków), Professor *Elise Poillot* (Paris), Professor *Judith Rochfeld* (Paris), Professor *Ewa Rott-Pietrzyk* (Katowice), Professor *Søren Sandfeld Jakobsen* (Copenhagen), Professor *Hans Schulte-Nölke* (Bielefeld, co-ordinator),

Professor *Reiner Schulze* (Münster), Professor *Carla Sieburgh* (Nijmegen), Dr. *Sophie Stalla-Bourdillon* (Florence), Professor *Matthias Storme* (Antwerp / Leuven), Dr. hab. *Maciej Szpunar* (Katowice), Professor *Evelyne Terryn* (Leuven), Dr. *Christian Twigg-Flesner* (Hull), Professor *Antoni Vaquer Aloy* (Lleida), Professor *Thomas Wilhelmsson* (Helsinki), Professor *Fryderyk Zoll* (Kraków).

The members of the *Redaction Committee* are, besides the speaker (*Gianmaria Ajani*) and the coordinator (*Hans Schulte-Nölke*) of the Acquis Group, *Gerhard Dannemann* (Chair), *Luc Grynbaum*, *Reiner Schulze*, *Matthias Storme*, *Christian Twigg-Flesner*, and *Fryderyk Zoll*. The *Terminology Group* consists of *Gerhard Dannemann* (Chair), *Silvia Ferreri* and *Michele Graziadei*.

Members of the individual Acquis Group Drafting Teams are: ‘Contract I’ (originally organised in the subteams Definition of Consumer and Business, Form, Good Faith, Pre-contractual Information Duties, Formation, Withdrawal, Non-negotiated Terms): *Esther Arroyo i Amayuelas*, *Martin Ebers*, *Christoph Grigoleit*, *Peter Møgelvang-Hansen*, *Barbara Pasa*, *Thomas Pfeiffer*, *Hans Schulte-Nölke*, *Reiner Schulze*, *Evelyne Terryn*, *Christian Twigg-Flesner*, *Antoni Vaquer Aloy*; ‘Contract II’ (responsible for Performance, Non-Performance, Remedies): *Carole Aubert de Vincelles*, *Piotr Machnikowski*, *Ulrich Magnus*, *Jerzy Pisulinski*, *Judith Rochfeld*, *Reiner Schulze*, *Matthias Storme*, *Maciej Szpunar*, *Fryderyk Zoll*; E-Commerce: *Stefan Leible*, *Jerzy Pisulinski*, *Fryderyk Zoll*; Non-discrimination: *Stefan Leible*, *Susana Navas Navarro*, *Jerzy Pisulinski*, *Fryderyk Zoll*; Specific Performance: *Lars Gorton*, *Geraint Howells*.

The former Commission on European Contract Law

The members of the three consecutive commissions of the Commission on European Contract Law which met under the chairmanship of Professor *Ole Lando* (Copenhagen) from 1982 to 1999 were: Professor *Christian von Bar* (Osnabrück), Professor *Hugh Beale* (Warwick); Professor *Alberto Berchovitz* (Madrid), Professor *Brigitte Berlioz-Houin* (Paris), Professor *Massimo Bianca* (Rome), Professor *Michael Joachim Bonell* (Rome), Professor *Michael Bridge* (London), Professor *Carlo Castronovo* (Milan), Professor *Eric Clive* (Edinburgh), Professor *Isabel de Magalhães Collaço†* (Lisbon), Professor *Ulrich Drobnig* (Hamburg), Bâtonnier Dr. *André Elvinger*, Maître *Marc Elvinger* (Luxembourg), Professor *Dimitri Evrigenis†* (Thessaloniki), Professor *Carlos Ferreira di Almeida* (Lisbon), Professor Sir *Roy M. Goode* (Oxford), Professor *Arthur Hartkamp* (The Hague), Professor *Ewoud Hondius* (Utrecht), Professor *Guy Horsmans* (Louvain la Neuve), Professor *Roger Houin†* (Paris), Professor *Konstantinos Kerameus* (Athens), Professor *Bryan MacMahon* (Cork), Professor *Hector MacQueen* (Edinburgh), Professor *Willibald Posch* (Graz), Professor *André Prum* (Nancy), Professor *Jan Ramberg* (Stockholm), Professor *Georges Rouhette* (Clermont-Ferrand), Professor *Pablo Salvador Coderch* (Barcelona), Professor *Fernando Martinez Sanz* (Castellon), Professor *Matthias E. Storme* (Leuven), Professor *Denis Tallon* (Paris), Dr. *Frans J. A. van der Velden* (Utrecht), Dr. *J. A. Wade* (The Hague), Professor *William A. Wilson†* (Edinburgh), Professor *Thomas Wilhelmsson* (Helsinki), Professor *Claude Witz* (Saarbrücken), Professor *Reinhard Zimmermann* (Regensburg).

The Compilation and Redaction Team

To co-ordinate between the Study and Acquis Groups, to integrate the PECL material revised for the purposes of the DCFR, and for revision and assimilation of the drafts from the sub-projects we established a “Compilation and Redaction Team” (CRT) at the beginning of 2006.

The CRT members are (or were) Professors *Christian von Bar* (Osnabrück), *Hugh Beale* (Warwick), *Eric Clive* (Edinburgh), *Johnny Herre* (Stockholm), *Jérôme Huet* (Paris), *Peter Schlechtriem*† (Freiburg i.Br.), *Hans Schulte-Nölke* (Bielefeld), *Matthias Storme* (Leuven), *Stephen Swann* (Osnabrück), *Paul Varul* (Tartu), *Anna Veneziano* (Rome) and *Fryderyk Zoll* (Cracow); it was chaired by *Eric Clive* and *Christian von Bar*. Professor *Clive* carried the; the main drafting and editorial burden at the later (CRT) stages; he is also the main drafter of the list of terminology in Annex 1 of the DCFR. He was assisted by *Ashley Theunissen* (Edinburgh). Over the course of several years *Johan Sandstedt* (Bergen) took care of the Mastercopy of this DCFR and repeatedly brought it up to date.

Funding

The DCFR is the result of years of work by many pan-European teams of jurists. They have been financed from diverse sources which cannot all be named here.³⁶ Before we came together with other teams in May 2005 to form the “Network of Excellence”³⁷ under the European Commission’s sixth framework programme for research, from which funds our research has since been supported, the members of the Study Group on a European Civil Code had the benefit of funding from national research councils. Among others the *Deutsche Forschungsgemeinschaft (DFG)* provided over several years the lion’s share of the financing including the salaries of the Working Teams based in Germany and the direct travel costs for the meetings of the Coordinating Group and the numerous Advisory Councils. The work of the Dutch Working Teams was financed by the *Nederlandse Organisatie voor Wetenschappelijk Onderzoek (NWO)*. Further personnel costs were met by the Flemish *Fonds voor Wetenschappelijk Onderzoek-Vlaanderen (FWO)*, the Greek *Onassis-Foundation*, the Austrian *Fonds zur Förderung der wissenschaftlichen Forschung*, the Portuguese *Fundação Calouste Gulbenkian* and the *Norges forskningsråd* (the Research Council of Norway). The Acquis Group received substantial support from its preceding Training and Mobility Networks on ‘Common Principles of European Private Law’ (1997-2002) under the fourth EU Research Framework Programme³⁸ and on ‘Uniform Terminology for European Private Law’ (2002-2006) under the fifth Research Framework Programme.³⁹ We are extremely indebted to all who in this way have made our work possible.

³⁶ A complete survey of the sponsors of the Study Group on a European Civil Code will be found in the opening pages of the most recent volume of the Study Group on a European Civil Code’s “Principles of European Law (PEL)” series (as to which see para. 26 above). The sponsors of the Commission on European Contract Law are mentioned in the preface of both volumes of the Principles of European Contract Law (fn. 1 above).

³⁷ “CoPECL: Common Principles of European Contract Law”.

³⁸ TMR (Training and Mobility) Network ‘Common Principles of European Private Law’ of the Universities of Barcelona, Berlin (Humboldt), Lyon III, Münster (co-ordinator of the Network: Professor Reiner Schulze) Nijmegen, Oxford and Turin. funded under the 4th EU Research Framework Programme 1997-2002.

³⁹ TMR (Training and Mobility) Network ‘Uniform Terminology for European Private Law’ of the Universities of University of Barcelona, Lyon III, Münster, Nijmegen, Oxford, Turin (co-ordinator of the Network: Professor Gianmaria Ajani), Warsaw, funded under the 5th EU Research Framework Programme 2002-2006.

TABLE OF DESTINATIONS

An entry in this table indicates a model rule which addresses the same legal issue as that dealt with in the relevant article of the PECL. It does not imply that the corresponding model rule is in the same terms or to the same effect.

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	4:109	II.-7:207
	4:110 (1) (2)	II.-9:404 – II.-9:406; II.-9:408 – II.-9:409 II.-9:407(2)
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TABLE OF DERIVATIONS

An entry in this table indicates an article of the PECL which addresses the same legal issue as that dealt with in the relevant model rule. It does not imply that the article of the PECL is in the same terms or to the same effect.

	DCFR Model Rules	PECL
Book I	I.-1:101 (1) (2) (3)	1:101(1) – –
	I.-1:102 (1) (2) (3) (4) (5)	1:106(1), 1st sent. – 1:106(1), 2nd sent. 1:106(2), 1st sent. –
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ARTICLES AND COMMENTS

BOOK I

GENERAL PROVISIONS

I.-1:101: Intended field of application

(1) These rules are intended to be used primarily in relation to contractual and non-contractual rights and obligations and related property matters.

(2) They are not intended to be used, or used without modification or supplementation, in relation to rights and obligations of a public law nature, or in relation to:

(a) the status or legal capacity of natural persons;

(b) wills and succession;

(c) family relationships, including matrimonial and similar relationships;

(d) bills of exchange, cheques and promissory notes and other negotiable instruments;

(e) employment relationships;

(f) the ownership of, or rights in security over, immovable property;

(g) the creation, capacity, internal organisation, regulation or dissolution of companies and other bodies corporate or unincorporated;

(h) matters relating primarily to procedure or enforcement.

(3) Further restrictions on intended fields of application are contained in later Books.

COMMENTS

The model rules are the core part of this Draft Common Frame of Reference (DCFR). It is anticipated that certain underlying governing principles will be set out in the Preamble. One of the main purposes of the DCFR is to act as an optional source of rules, concepts and terminology for those drafting legislative instruments and contracts. It is hoped that the rules may also prove useful to judges, arbiters, legal practitioners, researchers and law teachers.

Legislative acts and other instruments having binding force often have introductory provisions setting out their scope. However, the present rules have no binding force. They are there to be used and the way in which they may be used cannot be limited. So it would not be appropriate in this Article to state that the rules can be used only in certain areas and cannot be used in others. Nor would it be appropriate to set out in detail in this Article what is already set out in the table of contents. On the other hand, it is necessary to set out the main intended field of application and to indicate certain areas where the

rules are not intended to be used, or used without modification or supplementation. This is done partly in this Article and partly in later Books.

Paragraph (1) sets out positively the intended field of application of the rules. They are intended to be used primarily in relation to contractual and non-contractual rights and obligations and related property matters. The main focus of the earlier books is on contract law but there are provisions in later Books on, for example, non-contractual liability for damage caused to another (which often functions as an alternative to contractual liability), obligations to reverse unjustified enrichments (which often arise when a contract is void or avoided) and the transfer of property in movables (which is of particular importance in relation to the law on sale).

Paragraph (2) lists certain matters in relation to which the rules are not intended to be used, or used without modification or supplementation. Paragraph (2) does not mean that particular rules or concepts or terms could not be used in relation to the listed matters. The use to be made of the rules depends entirely on those using them. The paragraph just serves as a warning that the rules have not been drafted with the listed matters in mind. It may be anticipated, for example, that:

- (a) the rules on non-contractual rights and obligations would not necessarily be used, or used without restriction or modification, in relation to rights and obligations of a public law nature arising from a statute;
- (b) the rules on juridical acts would not be used in relation to marriage, where one would expect to find special rules on constitution, invalidity and termination;
- (c) the rules on representation would not necessarily be used in relation to the representation of those with mental incapacity, where special protections may be required, or in relation to the representatives of a deceased person, where special considerations apply,
- (d) the rules on obligations might be modified in their application to alimentary obligations where, for example, the resources of the debtor may affect the amount due, there may be limitations on the recovery of arrears and the ordinary rules on a plurality of debtors or creditors may be modified,
- (e) the rules on assignment would not be used in relation to the transfer of negotiable instruments,
- (f) the rules on contractual rights and obligations might be substantially modified or supplemented in relation to employment relationships,
- (g) the rules on contracts might be modified or supplemented in relation to contracts relating to the sale or lease of land, where special formalities and registration requirements may be required, and
- (h) the rules on juridical acts and representation would not be used in relation to the formation, running or dissolution of companies and other bodies corporate or unincorporate.

The list in paragraph (2) is not meant to function as an absolute exclusion. Indeed some matters within the list are dealt with incidentally in the following rules. For example, the

rules on proprietary security will sometimes apply to items which are temporarily attached to land or buildings and therefore technically immovable property. The list is indicative only. Moreover it is not meant to imply that there are no other matters where the rules might require modification before being used for a particular purpose.

Paragraph (3) is just a pointer to the fact that later Books contain further restrictions on their intended fields of application.

I.-1:102: Interpretation and development

(1) These rules are to be interpreted and developed autonomously and in accordance with their objectives.

(2) They are to be read in the light of any applicable instruments guaranteeing human rights and fundamental freedoms and any applicable constitutional laws.

(3) In their interpretation and development regard should be had to the need to promote:
(a) uniformity of application;
(b) good faith and fair dealing; and
(c) legal certainty.

(4) Issues within the scope of the rules but not expressly settled by them are so far as possible to be settled in accordance with the principles underlying them.

(5) Where there is a general rule and a special rule applying to a particular situation within the scope of the general rule, the special rule prevails in any case of conflict.

COMMENTS

This Article, like the rest of the rules, has no binding force. If legislators or contracting parties use provisions or terms from the rules in their own laws or contracts it will be the rules on the interpretation of those laws or contracts which apply. However, legislative drafters, judges, arbiters, commentators, legal researchers and others may have occasion to interpret the rules, or build upon them, and this Article is intended to provide guidance on an appropriate approach.

Paragraph (1) provides that the rules are to be interpreted and developed autonomously and in accordance with their objectives. The reference to autonomous interpretation is to emphasise that the rules form a coherent system and are to be interpreted in that context and not through the lenses of national private laws. The objectives can be derived not only from the preamble but also from the later articles and the comments on them. The rules are part of a draft common frame of reference. The benefits which might accrue from their use could be greatly reduced if they were to be interpreted in widely differing ways. This is one idea behind paragraph (1). Another idea is that those interpreting the rules are encouraged to adopt a liberal or purposive interpretation rather than a narrowly literal interpretation. This has a static and a dynamic aspect. The first envisages foreseeable situations which may occur today: the second, unforeseeable situations which

may occur in the future. The words “are to be ...developed” are important. They are addressed primarily to the courts and are intended to make it clear that judges can develop the principles and rules incrementally.

Paragraph (2) provides that the rules are to be read in the light of any applicable instruments guaranteeing human rights and fundamental freedoms and any applicable constitutional laws. This broad formula is used because it is not possible to foresee what instruments or constitutional laws (European or national) might be relevant in the future. This provision serves as a reminder that such overriding laws may, for example, provide defences to liability not specifically mentioned in the rules. Human rights requirements may, of course, have a direct and powerful effect of their own right in relation to legislation or contracts which use the rules. In relation to contracts, the rules themselves provide later that a contract is of no effect to the extent that it is contrary to principles recognised as fundamental in the laws of the Member States of the European Union.

Paragraph (3) exhorts those who may have to interpret and develop the rules to have regard to the need to promote uniformity of application, good faith and fair dealing, and legal certainty. The reference to uniformity of application reinforces the point made in the first paragraph of the Article. The need to promote uniformity of application may be met for example by looking at prevailing scholarly opinion on the meaning of the text and established trends in judicial application of the rules. The reference to good faith and fair dealing applies to the whole of the rules. It relates to the role of good faith and fair dealing in the interpretation and development of the rules – reflecting the fact that such ideas have played an important role in the development of many useful principles and rules in national private laws. Later Books contain specific references to good faith and fair dealing for other purposes - for example, the rule that parties must fulfil their obligations and exercise their rights in a way which is in accordance with good faith and fair dealing. The reference to legal certainty serves to some extent as a counterweight to the reference to good faith and fair dealing in relation to interpretation and development: it recognises that certainty is very important, particularly in relation to certain types of commercial contract.

Paragraph (4) recognises that this text is intended to be a dynamic instrument to be built on over the years. Inevitably, new problems will be identified where it does not provide a clear solution, even although the problems are within its general field of application. The point of this paragraph is to encourage those legislative drafters and contracting parties who are using this instrument to solve these new problems in a way which is consistent with the general principles underlying it. These principles, as we have just seen, include the need to promote good faith and fair dealing. The objective of paragraph (4) is to foster and encourage coherence in European private law. There is a similar provision in CISG Article 7(2).

Paragraph (5) is probably not strictly necessary because this would usually be the only reasonable way of dealing with a conflict between a general rule and a more special rule. In some legal traditions, however, legislative drafters have a tendency to insert

expressions such as “Subject to paragraph (3)” or “unless otherwise provided” whenever there is the slightest risk of conflict. The provision is intended to make it unnecessary to encumber the text with such expressions.

This Article is derived from Article 1:106(1) of PECL, with some drafting changes and additions.

I.-1:103: Definitions

(1) The definitions in Annex 1 apply for all the purposes of these rules unless the context otherwise requires.

(2) Where a word is defined, other grammatical forms of the word have a corresponding meaning.

COMMENTS

This Article introduces the list of definitions in Annex 1. As one of the main functions of this instrument is to provide a source of terms and concepts, the list of definitions is more extensive than might be normal in a legislative instrument. As it is extensive, it was considered preferable to have it at the end in an Annex rather than at the beginning, so as not to interrupt the flow of the articles.

In some cases the definitions in Annex 1 repeat definitions contained in the main text. It is hoped that it will be convenient for users to have all important definitions grouped together in the Annex in alphabetical order for ease of reference.

Paragraph (1) of the Article makes it clear that a particular provision may disapply or modify a definition for its own purposes

Paragraph (2) means, for example, that if “invalid” is defined then “invalidity” has a corresponding meaning.

I.-1:104: Computation of time

The provisions of Annex 2 apply in relation to the computation of time for any purpose under these rules.

COMMENTS

The CFR has several provisions which set time limits for various purposes. The Book on Prescription is the most obvious example. Many provisions also provide for a party to a contractual or other legal relationship to set time limits for something to be done. It is

necessary to have some general rules on how time is computed. Such rules may also be useful as model rules which could be adopted or modified for legislative or contractual purposes. Because the rules are rather long and technical they would be inappropriate in general provisions at the very beginning of the CFR. They are therefore introduced here and set out in detail in Annex 2.

I.-1:105: Meaning of “in writing” and similar expressions

(1) For the purposes of these rules, a statement is “in writing” if it is in textual form, on paper or another durable medium and in directly legible characters.

(2) “Textual form” means a text which is expressed in alphabetical or other intelligible characters by means of any support which permits reading, recording of the information contained in the text and its reproduction in tangible form.

(3) “Durable medium” means any material on which information is stored so that it is accessible for future reference for a period of time adequate to the purposes of the information, and which allows the unchanged reproduction of this information.

A text is “in directly legible characters” if the characters can be read without any change or conversion. Reading may be visual (letters printed on paper or carved in stone) or tactile (Braille letters). Sound recordings are not ‘in writing’ because they are neither in textual form (paragraph 2), nor directly legible. Also a DVD which stores text is “not directly legible”. *Illustration 1*

Air Company X sells tickets on the internet, referring to standard terms which are available and can be downloaded from the same webpage. This is sufficient for the “textual form” requirement in II.-3:105 (Formation by electronic means).

Illustration 2

As above, but the website is designed in such a way that the “save page” function is disabled. X cannot successfully argue that customers could nevertheless have recorded the terms using a special screenshot program, because X has not used a support which permits recording and reproduction.

I.-1:106: Meaning of “signature” and similar expressions

(1) A reference to a person’s signature includes a reference to that person’s handwritten signature, electronic signature or advanced electronic signature, and references to anything being signed by a person are to be construed accordingly.

(2) A “handwritten signature” means the name of, or sign representing, a person written by that person’s own hand for the purpose of authentication.

(3) An “electronic signature” means data in electronic form which are attached to or logically associated with other electronic data, and which serve as a method of authentication.

- (4) An “advanced electronic signature” means an electronic signature which is:**
- (a) uniquely linked to the signatory;**
 - (b) capable of identifying the signatory;**
 - (c) created using means which can be maintained under the signatory’s sole control;**
- and**
- (d) linked to the data to which it relates in such a manner that any subsequent change of the data is detectable.**
- (5) In this Article, “electronic” means relating to technology with electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.**

Illustration

A uses a so-called signature file which is attached to all email messages sent by A. It indicates A’s name, address, and telephone number. This provides information about A, but no authentication. So this is not an ‘electronic signature’, just as the use of stationery with a printed name and address cannot replace a handwritten signature.

BOOK II

CONTRACTS AND OTHER JURIDICAL ACTS

CHAPTER 1: GENERAL PROVISIONS

II.–1:101: Definitions

(1) A contract is an agreement which gives rise to, or is intended to give rise to, a binding legal relationship or which has, or is intended to have, some other legal effect. It is a bilateral or multilateral juridical act.

(2) A juridical act is any statement or agreement or declaration of intention, whether express or implied from conduct, which has or is intended to have legal effect as such. It may be unilateral, bilateral or multilateral.

COMMENTS

A. Contracts

The word “contract” is used in at least three different ways in current European and international texts. The word is used, first, in the “agreement” way given here. It is used, second, to indicate a legal relationship arising from a contract in the agreement sense. When it is said, for example, that a contract may be terminated in a certain way what is usually meant is that the legal relationship resulting from a contract may be terminated in that way. The word is used, third, to indicate a document in which the terms of a contract, in the agreement sense, are set out. An analysis of relevant EU and international legal texts shows that the “agreement” sense given here is, however, by far the preponderating sense in which the word is currently used in such texts.

The definition in the Article covers not only an agreement which creates or is intended to create rights and obligations but also an agreement which has or is intended to have some other legal effect. For example, an agreement to vary the terms of an existing contract, or to terminate an existing legal relationship between the parties, would itself be within the definition. An agreement which transfers property immediately, or assigns a right immediately, or renounces a right immediately, without there being any intermediate obligation to do so, would be a contract within the definition.

B. Juridical acts

The notion of a juridical act is a useful one. It covers not only contracts but also many other acts which are intended to have legal effect – including offers, acceptances, unilateral promises or undertakings intended to be binding without acceptance; unilateral

grants of authority to act as a representative; unilateral grants of consent or permission; unilateral acts of ratification or approval; unilateral acts of withdrawal, revocation, avoidance or termination; and unilateral acts granting, transferring or waiving rights. There is no essential difference between a unilateral promise intended to be binding without acceptance and a unilateral undertaking intended to be binding without acceptance. Both give rise to an obligation, often a conditional obligation. The difference is simply linguistic. In some contexts the word “promise” will be more natural - for example, when a person promises to pay a reward. In some contexts the word “undertaking” (defined in Annex 1 as the assumption of an obligation) will be more natural - for example, when a person assumes a security obligation. A unilateral promise or undertaking may merge into a contract if it is accepted by the person to whom it is addressed. The law needs to regulate many aspects of juridical acts.

The term “juridical act” is not universally used. The Principles of European Contract Law refer, for example, to “statements and other conduct indicating intention”. (See PECL Art. 1:107 which applies the Principles to such statements and conduct “with appropriate modifications”.) The reference to “intention” means in the context an intention to create some legal effect. The Rome Convention on the Law Applicable to Contractual Obligations talks of “a contract or other act intended to have legal effect”. (Article 14(2)) This is essentially the same as the definition used here but an adjective such as “juridical” is useful to distinguish this sort of act from other acts of a purely physical or non-legally-significant nature. The adjective “legal” might be considered but would have the disadvantage of suggesting a contrast with “illegal”.

II.-1:102: Party autonomy

(1) Parties are free to make a contract or other juridical act and to determine its contents, subject to the rules on good faith and fair dealing and any other applicable mandatory rules.

(2) Parties may exclude the application of any of the following rules relating to contracts or other juridical acts, or the rights and obligations arising from them, or derogate from or vary their effects, except as otherwise provided.

(3) A provision to the effect that parties may not exclude the application of a rule or derogate from or vary its effects does not prevent a party from waiving a right which has already arisen and of which that party is aware.

COMMENTS

Like the national legal systems of the European Union, this instrument acknowledges the right of the citizens and their enterprises to decide with whom they will make their contracts and to determine the contents of these contracts. The principle of freedom of contract is a key principle. This principle of party freedom extends also to the making of other juridical acts.

The principle of freedom of contract and other legal action is, however, always subject to important restrictions. This instrument cannot itself impose restrictions as it is not a legislative instrument. The present Article recognises, however, that any legislator using provisions from the model rules would wish to impose certain restrictions. Some Articles do indicate that they are intended to be mandatory or that derogations from them would have only a limited effect. For example, derogations to the detriment of a consumer might be ineffective. The effect of such provisions is, of course, not actually to make the Articles mandatory or to limit the effect of derogations. This instrument cannot do that. The effect is just to indicate that if a legislator were to adopt the rules it might be expected to make them mandatory or to limit the effect of derogations. The following comments must be read in the light of these preliminary observations.

Paragraph (1) of the Article provides that the parties' freedom to make a contract and to determine its contents is subject to the requirements of good faith and fair dealing and any applicable mandatory rules. This is just a reminder that party autonomy is not absolute. The freedom to decide with whom to contract, the freedom to conclude or not conclude a contract, and the freedom to formulate the terms of a contract may all be limited in one way or another, and similarly for other juridical acts. This instrument itself indicates certain rules which restrict party autonomy and which are intended to be regarded as mandatory.

It does not follow from this provision that an offending contract will always be invalid. It may sometimes be, but the consequences of non-compliance or infringement is determined by later Articles or other rules. For example, a contract concluded by fraud or unfair exploitation would be liable to be avoided under the rules on these subjects (see II.-7:205 (Fraud) and II.-7:207 (Unfair exploitation)) but would not be automatically invalid. A provision in a contract which said that one party reserved the right to ignore any duty to act in accordance with good faith and fair dealing without this having any consequences whatsoever would be ineffective because a later Article (III.-1:103 (Good faith and fair dealing)) provides that the parties cannot contract out of this duty. A contract for the transport of slaves would be contrary to principles recognised as fundamental in all Member States and would be automatically void (see II.-7:301 (Contracts infringing fundamental principles)). A contract contrary to some less fundamental mandatory rule would have the effect determined by that rule or, if no such effect was laid down, might be avoided in whole or in part, or modified, by a court (see II.-7:302 (Contracts infringing mandatory rules)).

The freedom to conclude a contract implies the freedom not to do so, but again party autonomy is not absolute. The reference to good faith and fair dealing is relevant here. Breaking off negotiations contrary to good faith and fair dealing may give rise to liability in damages.

One effect of paragraph (2) is that each provision on contract law in the following rules has to be read as if it began, “unless the contract otherwise provides”. The paragraph is intended to save a great deal of repetition in later Articles.

Paragraph (3) is designed to avoid a doubt which has sometimes arisen. The fact that a rule is mandatory does not prevent any right which has already arisen under that rule from being waived. In particular it does not prevent a party from settling any dispute relating to that right.

II.-1:103: Binding effect

(1) A valid contract is binding on the parties.

(2) A valid unilateral promise or undertaking is binding on the person giving it if it is intended to be legally binding without acceptance.

(3) This Article does not prevent modification or termination of any resulting right or obligation by agreement between the debtor and creditor or as provided by law.

COMMENTS

A. Binding character of contracts

The first sentence of paragraph (1) of this Article expresses one of the most fundamental and general principles of European contract law. Valid contracts are binding on the parties. *Pacta sunt servanda.*

B. Binding character of a unilateral promise or undertaking

A contract is defined in terms of an agreement. If there is no agreement there is no contract. Often an agreement can be spelled out of conduct indicating acceptance. However, this is not always possible. Sometimes there is simply a unilateral promise or undertaking which is intended to be binding without acceptance. To force such cases into the contractual mould can be artificial and unconvincing. A more direct approach can be taken. The promise is itself binding.

Paragraph (2) is derived from Article 2:107 of the Principles of European Contract Law. The words “or undertaking” are added to make it clear that there is no requirement that the word “promise” be used before there will be binding effect. An “undertaking” is defined in Annex 1 as an assumption of an obligation. Any expression which clearly indicates an intention to be legally bound will suffice – for example, “I undertake to”, or “I bind myself to” or “we assume an obligation to” or “we hereby guarantee”.

Some legal systems do not enforce a party’s unilateral promise or undertaking even if it is intended to be legally binding without acceptance. Some do so but only if it is not

gratuitous or is couched in a solemn form or is found to serve a socially desirable purpose which cannot be achieved by other means.

The fear that the enforcement of such promises or undertakings will lead to socially undesirable results is not well founded. In fact many of these promises serve legitimate commercial purposes.

Nor is it necessary to inquire into the social desirability of the promise or undertaking if it is sincerely made. Experience shows that the legal systems which enforce gratuitous promises (whether they are intended to be binding without acceptance or were intended to be, and were, accepted and thus fall within the definition of a contract in II.–1:101 (Definitions) do not in general encounter problems. People of sound mind do not normally assume obligations without good reason. In *some* cases a requirement of writing may be justified (see II.–1:107 (Form) and the Comments on it), but that is a different question from the question whether a unilateral promise or undertaking can be binding. On the other hand, those legal systems which do not enforce “gratuitous” promises have faced problems when such promises sincerely made have since been revoked. These problems arise in a most acute form when the promisee has acted in reasonable reliance on the promise, but they do not arise only in this case. Legitimate expectations fall to be respected even if there has been no actual reliance. The position in this respect is similar to that encountered in the case of contracts.

Leaving aside exceptional cases where some requirement of writing may be justified for special reasons, on balance it appears to be justifiable and desirable to regard unilateral promises or undertakings as binding if they are intended to be binding without acceptance; and (as is provided expressly in II.–1:107 (Form)) not to subject all such promises or undertakings to formal requirements. Of course, they must be valid. They may, for example, like contracts, be avoided for mistake or fraud or threats and so on. See Chapter 7 (Grounds of Invalidity).

C. Unilateral promise and offer distinguished

An offer is a promise which requires acceptance. An offeror is not bound by the promise unless it is accepted. Other promises are binding without acceptance. Whether there is such a promise depends on the language of the promise or other circumstances. The promise must of course be communicated to the promisee or to the public.

Illustration 1

When the Gulf War started in 1990 the enterprise X in country Y published a statement in several newspapers in Y promising to establish a fund of €1 million to support the widows and dependent children of soldiers of country Y who were killed in the war. After the war X tried to avoid payment invoking big losses recently made. X will be bound by its promise.

D. Modification or termination

Paragraph (3) is added to make it clear that the fact that a contract or juridical act can create obligations does not mean that those obligations cannot be modified or terminated by agreement between the debtor and the creditor or as provided by law. (The debtor and creditor will not necessarily be the original parties to a contract: there may have been an assignment of the creditor's right or a substitution of a new debtor or a transfer of one party's whole contractual position.) Very often a contract will itself provide a mechanism whereby its terms can be varied. Variation in accordance with such a mechanism is simply giving effect to the contract. The reference to modification or termination "as provided by law" takes account, for example, of the later provisions on termination for non-performance of a contractual obligation (see Book III, Chapter 3, Section 5) and of the provisions which, exceptionally, enable a court to modify the terms of a contract or terminate the contractual relationship altogether in certain situations (see III.-1:110 (Variation or termination by court on a change of circumstances)).

E. Commercial importance of unilateral undertakings

Many promises or undertakings made in the course of business are binding without acceptance and it is important in practice that they generally should be. An irrevocable documentary credit issued by a bank (the issuing bank) on the instructions of a buyer binds the issuing bank; a confirmation of such a credit by an advising bank binds the bank as soon as it is delivered to the seller. Some assumptions of security obligations also fall under this category (see further Book IV Part G (Personal Security)).

Illustration 2

C sends a letter to the creditors of its subsidiary company D, which is in financial difficulties, promising that C will ensure that D will meet its existing debts. The promise is made in order to save the reputation of the group of companies to which C and D belong. It is binding upon C without acceptance since it is to be assumed that C intends to be bound without the acceptance of each creditor.

We will see below (II.-4:202 (Revocation of offer)) that an offer which is stated to be irrevocable or which subject to a fixed time limit for acceptance may not be revoked within the period. In this case making the offer itself amounts to a unilateral juridical act which is binding without acceptance, since it carries with it an express or implied unilateral promise not to revoke it.

II.-1:104: Usages and practices

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

(2) The parties are bound by a usage which would be considered generally applicable by persons in the same situation as the parties, except where the application of such usage would be unreasonable.

(3) This Article applies to other juridical acts with any necessary adaptations.

COMMENTS

A. Scope

This Article deals with usages and with practices which the parties to a contract have established between themselves. Under paragraph (1) a usage applies if the parties have expressly or tacitly agreed that it should. Under paragraph (2) a usage which would be considered applicable by persons in the same situation as the parties will bind them even without their agreement, provided the usage is not unreasonable and is consistent with the express terms of the agreement.

A usage may be described as a course of dealing or line of conduct which is, and for a certain period of time has been, generally adopted by those engaged in a trade or other activity.

A practice which the parties have established between themselves may arise as a result of a sequence of previous conduct to a particular transaction or a particular kind of transaction between the parties. It is established when their conduct may fairly be regarded as a common understanding. The conduct may not only lend a special meaning to words and expressions which they use between themselves but may also create rights and duties.

B. Priority of usages and practices over the rules of law

Both usages and practices will, when applicable, preclude the application of default rules of law which are designed to fill gaps in a contract. However, although not stated, it is implicit in the Article that usages and practices are only valid in so far as they do not violate mandatory rules of the law applicable to the contract or to the particular issue in question.

C. Parties refer to a usage

Sometimes the parties may refer to a usage which otherwise would not operate between them under the second paragraph of the Article. Such a usage then becomes binding under the first paragraph.

Illustration 1

A, who operates in Copenhagen and who has bought a commodity in Hamburg resells it to B, who also lives in Copenhagen. In their contract the parties agree to have the local usages of the Hamburg Commodity Exchange apply. These usages will then bind both of them.

D. A practice between the parties

A practice established between the parties may vary their initial agreement, and it may create other mutual rights and obligations between them.

Illustration 2

Having been called a couple of times to fill A's oil tank, B, on the basis of information received regarding A's consumption, has done so for more than 5 years without having been called. B has seen to it that A, whose factory is dependant on the oil, never runs out of oil. A has always paid B close to but not later than 90 days after receipt of the oil.

The initial agreement between the parties that B should only fill the tank when called upon has been changed by their practice; an obligation on B to see to it that the tank never runs out of oil has been created. Also, although never expressly agreed upon, a practice between the parties extending to a credit of not more than 90 days after receipt has been established between them.

It goes without saying that the parties may later agree to vary a practice which they have established between them.

In case of a conflict between a practice between the parties and a usage not agreed upon by the parties, the former will take precedence over the latter.

E. Usages not agreed upon

A usage may operate without having been agreed upon by the parties (provided that the parties have not agreed, expressly or by implication, to exclude it). For such a usage to be binding, paragraph (2) of the Article requires that it is one which would be considered applicable by persons in the same situation as the parties and is not unreasonable.

The usage must be so well established and have such general application among those engaged in the trade or activity that persons in the same situation as the parties would consider it applicable. Parties may thus be bound by usages which have application to all or several trades and by usages which apply in a particular trade only.

The Article applies to local, national and international usages. A usage may be international either in the sense that it operates in the world trade, or in the sense that in a contract between parties which have their place of business in two different states, it operates in both states.

A local or national usage which operates at the place of business of one of the parties but not at that of the other party can only bind the latter if this would be reasonable. A party who comes into a market of the other party will often be bound by the local usages.

Illustration 3

A in Brussels sends an order to B, a broker in Paris, to be executed on the Paris Stock Exchange. A is ignorant of stock exchange transactions and has no knowledge of the usages of the Paris exchange. A can, therefore, have no intention to submit to these usages. Nevertheless the order is to be executed in accordance with the reasonable usages of the Paris Stock Exchange.

Illustration 4

A, a merchant from Milan, goes to London and there negotiates and concludes a contract to deliver to B in London "ground walnuts". These words mean a finer grinding in London than the corresponding expression does in Milan. Unless otherwise agreed the contract is taken to refer to the London usage.

The application of a usage must not be unreasonable. A usage can never set aside a mandatory rule of law, but if the law merely supplies a term in the absence of contrary agreement, the usage may reverse what would otherwise be the normal rule, provided its application is not unreasonable. Commercial acceptance by regular observance by business people is some evidence that the usage is reasonable but even a usage which is regularly observed may be disregarded by the court if it finds the application of the usage unreasonable.

The way in which the usages are ascertained - through expert witnesses, by opinions submitted by the national or local Chamber of Commerce etc. - is decided by the applicable national law.

F. Other juridical acts

Paragraph (3) applies the rules in the Article, with any necessary modifications, to other juridical acts. In the case of certain unilateral juridical acts, such as offers or notices of withdrawal of offers, for example, the word "parties" may have to be regarded for the purposes of paragraph (1) as referring to the parties to a pre-contractual relationship. In certain other cases the word "parties" may have to be regarded as referring to the sole party involved. In such a case, of course, the references in paragraph (1) to usages or practices agreed between the parties will be inapplicable, but paragraph (2) could still apply.

Illustration 5

It is a well-established usage in a certain trade that the sending of a request to act in a certain form confers authority to act in accordance with the rules of the trade association. A person engaged in that trade who sends such a form will be bound by the usage and could not argue that the rule in the Article is inapplicable because there is no contract but only a unilateral act.

II.-1:105: Imputed knowledge etc.

If any person who with a party's assent was involved in making a contract or other juridical act or in exercising a right or performing an obligation under it:

(a) knew or foresaw a fact, or is treated as having knowledge or foresight of a fact; or

*(b) acted intentionally or with any other relevant state of mind
this knowledge, foresight or state of mind is imputed to the party.*

COMMENTS

A. Purpose

It is the purpose of this Article to neutralise the legal risks inherent in the modern division of labour in trade and industry. This is achieved by imputing actual or constructive knowledge or a legally relevant state of mind, such as intention, negligence or bad faith, of a person assisting in the making of a contract or other juridical act, or in exercising rights or performing obligations under it, to the party to whom that assistance is rendered.

The issues covered by this Article are not always clearly regulated in the existing national laws. The Article represents what are thought to be the principles which underlie each law's approach, shorn of the technical concepts that many laws use to arrive at much the same results.

B. Scope

Under modern conditions, most contracts are not concluded by the contracting parties personally. Rather, at least one and often each party makes the contract through the agency of employees or other persons and entrusts performance of the obligations under the contract to employees, representatives, subcontractors and other third persons. A later Article (III.-2:107 (Performance by a third person)) provides that a party cannot escape from an obligation by delegating it to another; if the obligation is not performed, the party will remain responsible. The present Article is complementary to that Article. It deals with other aspects of this modern division of labour, namely the imputation to the contracting party of actual or constructive knowledge of persons assisting in the making of a contract or the performance of obligations under it (paragraph (a)) and with the imputation of intention or some other relevant state of mind such as negligence. The same considerations apply to other juridical acts, such as the giving of legally effective notices for various purposes.

The clearest case of a person acting with the assent of a party in performing a contractual or other similar obligation is where the debtor in the obligation has entrusted performance to that person. However, a third person may nevertheless under certain conditions be entitled to perform the obligation. If the third person acted with the debtor's assent that is equivalent to an entrustment and therefore falls under the present Article.

In contrast, if the third person has acted only by virtue of a legitimate interest in the performance, and not with the assent of the debtor, that falls outside the scope of the Article.

C. Imputed knowledge and foresight

Many of the following rules use the criteria of knowledge, awareness or foresight. A party who could reasonably be expected to have known or foreseen a fact is often treated as having had the knowledge or foresight.

When a contract is being made, a party is normally only fixed with the knowledge imputed to the party's employees or representatives involved in making the contract. Under some Articles, knowledge or foreseeability at the time of non-performance is relevant. In this case, knowledge or intention even of any subcontractor or other person to whom performance has been entrusted may be imputed to the party.

However, there is one limitation. The employee or other person must have been someone who was, or who appeared to be, involved in the negotiation or performance of the contract. If a person not so related to the contract knows a relevant fact he or she may not be able to appreciate its relevance to the contract and thus might not report it. The burden of proving that the person for whom the contracting party is held responsible was not and did not reasonably appear to the other party to be involved in the making or performance of the contract rests on the first party.

D. Imputed intention, etc.

According to paragraph (b), certain states of mind or behaviour of the person acting are also imputed to the contracting party for whom a contract has been concluded or an act of performance is rendered (and similarly for other juridical acts).

Under several rules, intentional or similar behaviour or bad faith by a party creates or increases liability. However, it should be noted that, under the following rules on contractual and other voluntary obligations, liability is not generally based on the notion of fault. This limits the scope of the Article.

The intentional or other behaviour of a party or of a person whose state of mind is imputed to a party only refers to the act or omission which constitutes the non-performance. It is not necessary that the intention or state of mind also extend to the consequences which may follow from the non-performance.

II.-1:106: Notice

- (1) This Article applies in relation to the giving of notice for any purpose under these rules. "Notice" includes the communication of a promise, offer, acceptance or other juridical act.*
- (2) The notice may be given by any means appropriate to the circumstances.*
- (3) The notice becomes effective when it reaches the addressee, unless it provides for a delayed effect.*
- (4) The notice reaches the addressee:
 - (a) when it is delivered to the addressee;*
 - (b) when it is delivered to the addressee's place of business, or, where there is no such place of business or the notice does not relate to a business matter, to the addressee's habitual residence;*
 - (c) in the case of a notice transmitted by electronic means, when it can be accessed by the addressee; or*
 - (d) when it is otherwise made available to the addressee at such a place and in such a way that the addressee could reasonably be expected to obtain access to it without undue delay.**
- (5) The notice has no effect if a revocation of it reaches the addressee before or at the same time as the notice.*
- (6) Any reference in these rules to a notice given by or to a person includes a notice given by or to a representative of that person who has authority to give or receive it.*
- (7) In relations between a business and a consumer the parties may not, to the detriment of the consumer, exclude the rule in paragraph (4)(c) or derogate from or vary its effects.*

COMMENTS

A. Scope

The Article applies to the giving of a notice for any purpose of the rules. "Notice" is defined for this purpose as including the communication of a promise, offer, acceptance, or other juridical act. Essentially it is about the communication of juridical acts, which is why it is in this Book rather than Book I. This is only an inclusive definition. Anything which is, or could be, described as a notice in the rules is covered. The Article would clearly cover notices of revocation, termination, withdrawal and notices giving extra time for performance and so on.

B. The form of notices

Notices may be made in any form - orally, in writing, by fax or by electronic mail, for example - provided that the form of notice used is appropriate to the circumstances. It would not be consistent with good faith and fair dealing for a party to rely on, for instance, a purely casual remark made to the other party. For notices of major importance written form may be appropriate.

C. The receipt principle

The general rule adopted here is that a person cannot rely on a notice sent to another person unless and until the notice reaches that person. It is not normally necessary that the notice should actually have come to the addressee's attention provided that it has been delivered in the normal way, e.g. a letter placed in the letter box or a message sent to the fax machine. Similarly the risk of errors in the transmission of the notice is normally placed upon the sender. The principle of good faith and fair dealing means that a person cannot complain that a notice has not been received, or has not been received in time, if the person has deliberately evaded receiving it.

Illustration

A notice to extend a charterparty must be given to the owner's office, which is open round the clock, by 17.00 on April 1. The charterer telephones at 16.59. The owners are expecting the call but do not want the charter to be extended. Therefore they deliberately let the phone ring until after 17.00 has passed; they then answer it and say that the notice is too late. The notice is treated as having been given in time.

D. Only "unless otherwise provided"

In accordance with the general rule that a specific provision will override a more general one, the rules in the Article apply only unless otherwise provided. Particular provisions in later Books may provide special rules for notices of certain types or given in certain circumstances. One important example of such special rules is the Article which provides that when one party to a contract gives a notice to the other because of the other's non-performance the risk of non-receipt falls on the defaulting party. This is an application, in this particular context, of what is known as the "dispatch principle".

E. When notice "reaches" addressee

This is regulated by paragraph (4). It will be noticed that the notice need not actually reach the addressee in person. Under sub-paragraph (b) it is regarded as reaching the addressee when delivered to the addressee's place of business or, if there is no such place of business or the notice relates to a personal matter, to the addressee's habitual residence. Sub-paragraph (c) covers the special case of notices transmitted by electronic means. Here the notice reaches the addressee when it can be accessed by the addressee. Sub-paragraph (d) covers other situations in which a notice could be regarded as having reached the addressee – such as, for example, leaving a message in a place which the addressee is known to check regularly.

F. Simultaneous withdrawal

A notice is not effective if at the same time, or earlier, the recipient gets a withdrawal or countermand of the notice.

G. Notices by or to representatives

Paragraph (6) of the Article provides, for the avoidance of doubt, that any reference to a notice given by or sent to a person includes a reference to a notice given by or sent to a representative with authority to give or receive it.

H. Electronic transmission

Paragraph (7) contains a special rule for messages transmitted by electronic means. In accordance with paragraph (4)(c) the normal rule is that the message reaches the addressee when it can be accessed by the addressee. Normally parties can contract out of the rules in this Article. However, for the protection of consumers, paragraph (7) makes it clear that in business-to-consumer relations this rule is mandatory in favour of the consumer. In other words the business cannot stipulate that an electronic message is to be deemed to reach the consumer before it can be accessed by the consumer.

II.-1:107: Form

(1) A contract or other juridical act need not be concluded, made or evidenced in writing nor is it subject to any other requirement as to form.

(2) Particular rules may require writing or some other formality.

COMMENTS

This Article lays down the general principle that there is no formal requirement for a contract or other juridical act. This may be displaced by a particular provision on a particular topic but, in general, there is no need for writing, sealing, authentication by a notary, filing in a public registry or anything else. This principle is widely accepted among the legal systems at least as far as commercial contracts are concerned. For international contracts it is particularly important since many such contracts have to be concluded or modified without the delays which the observance of formalities will cause.

In some cases the model rules themselves require writing for a particular juridical act and national laws often do the same, particularly in relation to land. This is expressly recognised by paragraph (2). Any legislator using the model rules is, of course, free to prescribe writing or any other formality in relation to any type of contract or other juridical act. It is important, however, to establish the basic rule that there is no formal requirement unless otherwise provided.

One context in which a requirement of writing may be called for is that of certain promises or undertakings to make a donation. Many legal systems impose formal requirements in such cases, in order to provide evidence that the promise was actually made (the “evidentiary function”) and was intended to be legally binding (the “channelling function”) and at the same time to encourage the promisor to stop and think before assuming an obligation which may turn out to be burdensome (the “cautionary

function”). This issue will be dealt with in a later Part of Book IV (on Gratuitous Contracts), which is not included in this Interim Outline Edition but will be included in the final version to be published later.

Another context is which a requirement of writing may sometimes be called for is that of consumer protection. See, for example, IV.G.–4:104 (Form) in relation to consumer contracts for the provision of personal security.

As will be seen from the comparative notes, the present Article represents the law of the majority of Member States in that there are no general requirements of writing. However these model rules as a whole require formality in fewer specific cases than do many laws. Experience shows that formal requirements can hinder commerce and can enable parties to escape obligations for no good reasons. Most systems have developed mechanisms to limit unjustified evasions, but the better approach is to target formal requirements on cases in which they are really needed.

II.–1:108: Mixed contracts

- (1) For the purposes of this Article a mixed contract is a contract which contains:***
 - (a) parts falling within two or more of the categories of contracts regulated specifically in these rules; or***
 - (b) a part falling within one such category and another part falling within the category of contracts governed only by the rules applicable to contracts generally.***
- (2) Where a contract is a mixed contract then, unless this is contrary to the nature and purpose of the contract, the rules applicable to each relevant category apply, with any appropriate adaptations, to the corresponding part of the contract and the rights and obligations arising from it.***
- (3) Paragraph (2) does not apply where:***
 - (a) a rule provides that a mixed contract is to be regarded as falling primarily within one category; or***
 - (b) in a case not covered by the preceding sub-paragraph, one part of a mixed contract is in fact so predominant that it would be unreasonable not to regard the contract as falling primarily within one category.***
- (4) In cases covered by paragraph (3) the rules applicable to the category into which the contract primarily falls (the primary category) apply to the contract and the rights and obligations arising from it. However, rules applicable to any elements of the contract falling within another category apply with any appropriate adaptations so far as is necessary to regulate those elements and provided that they do not conflict with the rules applicable to the primary category.***
- (5) Nothing in this Article prevents the application of any mandatory rules.***

COMMENTS

Book IV has a number of Parts on specific types of contracts – for the sale of goods, for the supply of services, for mandate, for franchises and similar long-term “framework” contracts, for the lease of goods, for the provision of personal security, for donation etc. The problem is that there may be mixed contracts – e.g. a contract to construct and sell, or a contract to sell and provide a training service, or a contract to lease and sell. There are many such contracts. Which special rules, if any, then apply and how?

It might be tempting to argue that cases of mixed contracts really involve two or more contracts. So the problem disappears. This might be a possible argument in systems with a different notion, or a vague and flexible notion, of what a contract is. However, it does not work under these rules where a contract is defined as a type of agreement – a juridical act. If there is one agreement – often constituted by an offer and an acceptance – there is one contract. It is quite normal under these rules for a contract to give rise to several sets of reciprocal obligations. So the problem of mixed contracts cannot always be avoided by saying there are really two or more contracts. Of course there may in fact be two or more contracts. If each is a pure contract then the case is no longer one in the realm of mixed contracts.

However, although this “two contract” solution does not work under the present rules it contains a pointer to the appropriate solution. It will often be a mere matter of chance whether there is one contract or two. This suggests that the practical results should preferably not differ depending on whether the parties conclude one contract or two. This is one reason for the solution adopted in the Article. Another reason is that all alternative solutions seem unacceptable. To apply only one set of special rules would leave the other part of the contract unregulated by the rules specially created for it. To apply only the general rules of Books I to III would be open to the same objection in relation to both parts of the contract. To create specially designed rules for every conceivable type of mixed contract would be impracticable.

So the Article opts for the solution which involves applying the relevant set of rules to the relevant part of the mixed contract. This basic policy is slightly modified to deal with some special situations.

Paragraph (1) defines what is meant by a mixed contract for the purposes of the Article. Paragraph (1)(b) is not meant to deal with a contract which is partly governed by special rules and partly by the general rules. A pure contract of sale would then be governed by the rules on mixed contracts. This is not what is intended and not what is said. The provision is, as its wording indicates, intended to deal with contracts which contain a part falling within one category and *another* part falling only within the general rules.

Illustration 1

A contract provides for something to be donated and also for something not to be done. The part of the contract which deals with the donation falls under the special rules for contracts of donation in Book IV. The part which contains an obligation not to do something falls under only the general rules in Books I to III. This is a mixed contract for the purpose of the Article.

Paragraph (2) is meant to deal with cases where the two matters might just as well have been dealt with in separate contracts but the parties chose to deal with them in one contract. For example, where a contract obliges one party to sell a machine and then to provide a training course in how to use it, the sales rules would apply to the sale part of the contract and the services rules would apply to the training part of the contract. Similarly, if a contract obliges one party to buy goods from the other and then lease them back to the other, the sales rules would apply to the sale part of the contract and the leases rules to the lease part. Another important type of mixed contract which would often fall under the rule in paragraph (2) is a contract for sale and processing, or processing and sale. For example, a garage agrees to sell and fit a new tyre or an exhaust. Or an engineer agrees to repair a machine at so much per hour and sell the client at list prices any parts necessary for the job. An advantage of this approach is that it enables the same solution to be reached whether the parties conclude one contract or two. The words “unless this is contrary to the nature and purpose of the contract” are inserted to cover cases where although the contract contains elements of specific types of contracts it is clearly designed to be governed only by the general rules or only, perhaps, by a special set of standard terms. Paragraph (5) prevents this possibility from being used to avoid mandatory rules.

Paragraphs (3) and (4) are meant to deal with other contracts, such as contracts for construction and sale, where one part is purely incidental to the other. They cover two situations.

Paragraph (3)(a) covers the situation where a rule provides that a certain type of mixed contract is to be regarded as primarily a contract falling within one category. For example, there is a rule in the Sales provisions to the effect that a contract for the manufacture of goods and the transfer of the ownership of them to the ordering party, in exchange for a price, is to be considered as primarily a contract for sale. The reasoning is that the construction is for the purposes of the sale. It is a means to an end. The ordering party is primarily interested in getting an end product which conforms to the contract.

However, special rules of this type cannot be devised for every possible situation which might arise and would not be appropriate in many cases. So paragraph (3)(b) covers the situation where one part of a mixed contract is in fact so dominant that the contract can only reasonably be regarded as falling primarily within one category. For example in a contract for hotel accommodation, a part of the price is for the right to use movables, such as bed, chair, TV, towels etc. Yet most people would regard it as artificial to say that the contract was a mixed contract, one part of which was a contract for the lease of

movables. The lease of movables is purely incidental. Similarly, the short-term storage of goods is often an incidental element of a contract which is primarily of another nature. And the repairing obligations of a lessor under a contract for the lease of movables will usually be best regarded as merely an incidental aspect of a contract for lease.

For a contract under paragraph (3), which either in law or in fact is primarily of a certain type and only incidentally of another type, paragraph (4) provides that the dominant rules prevail. The rules applicable to the incidental part apply only so far as necessary and only so far as they do not conflict with the dominant rules. In a contract for the construction and sale of a boat, for example, the sales rules on conformity and the passing of risk will apply at the end of the construction process to the exclusion of the construction rules. The construction rules might still fall to be applied to questions arising during the construction process – for example, if the client wanted to change the specification or if the constructor became aware of something of which the client ought to be warned. Similarly in a contract with a hotel, the general rules on services would apply. In theory the rules on leases of movables could apply incidentally and so far as necessary but in practice it is hard to imagine a case where it would be necessary to apply them to the normal movables (bed, chair, table etc) which the guest has the right to use. However, the rules on mixed contracts (probably paragraph (2)) would naturally apply if a guest made a special arrangement, but under the one contract, for the hire of a special piece of equipment during his or her stay at the hotel.

One of the dangers of allowing one set of rules to prevail in a mixed contract is that mandatory rules designed to protect certain people, such as consumers, might be denied effect. Paragraph (5) therefore expressly preserves the effect of mandatory rules.

II.-1:109: Partial invalidity or ineffectiveness

Where only part of a contract or other juridical act is invalid or ineffective, the remaining part continues in effect if it can reasonably be maintained without the invalid or ineffective part.

COMMENTS

There are various situations in which a contract or other juridical act may be partly invalid or ineffective. A term may infringe the rules on unfair contract terms and may be ineffective as a result. A term may be contrary to some fundamental principle and therefore void or it may infringe a mandatory rule which says that it is to be void or invalid or ineffective. Part of a contract may be invalid because of failure to comply with a formal requirement for validity. A contract may, for example, be partly for donation and partly for sale or the provision of a service. The rules on contracts for donation may require writing. They will apply to the donation part but not to the other parts. See the preceding Article.

Consistently with the general intention of preserving contractual relationships so far as possible, this Article provides the possibility that if a contract is invalid or ineffective only in part the remainder of the contract continues to be valid and effective unless this would be unreasonable in all the circumstances. Circumstances which might be taken into account in assessing the reasonableness of upholding the remaining part include whether or not the contract has any independent life without the invalidated part; whether the parties would have agreed to a contract consisting only of the remaining parts of the contract; and the effect of partial invalidity upon the balance of the respective obligations of the parties as performance and counter-performance.

CHAPTER 2: NON-DISCRIMINATION

II.-2:101: Right not to be discriminated against

A person has a right not to be discriminated against on the grounds of sex or ethnic or racial origin in relation to a contract or other juridical act the object of which is to provide access to, or supply, goods or services which are available to the public.

COMMENTS

A. General

This Article and the following express a general prohibition of any discrimination on the grounds of sex, ethnicity or racial origin. Their content has mainly been harvested in EC Law. As these model rules are drafted with a view to being used in the field of contract law (excluding labour law) and patrimonial law, the non-discrimination rules set out here contain just a part of the much broader general law on non-discrimination. The two main limitations of these provisions are, firstly, the rather short list of prohibited discrimination criteria (just ‘sex’ or ‘ethnic or racial origin’), which reflect the current status of EC law in the field of general contract law (see below under C) and, secondly, the limitation to certain contracts on goods and services ‘available to the public’ (see below under D). This is by no means meant as a political statement in the sense that non-discrimination law should not be broadened according to the example of some national laws. By contrast, the rules are drafted in such a way that it should be fairly easy to add further discrimination criteria and situations if a legislator so wants.

B. Context

This Article is not a complete rule. It is only a part of the rule and needs to be read with other provisions in this Chapter. II.-2:102 (Meaning of discrimination) contains a definition of discrimination while II.-2:103 (Exception) provides a possible justification where unequal treatment is the result of a legitimate aim. II.-2:104 (Remedies) makes clear that an infringement of the right not to be discriminated against granted under this Article triggers, without prejudice to any other remedies available, the remedies for non-

performance of an obligation under Book III, Chapter 3. As the heading of the Article indicates, the right stated here forms not only a part of contract law, but also fulfils functions traditionally associated with the law on non-contractual liability for damage. The general provisions on non-discrimination law are nevertheless located in Book II (Contracts and other juridical acts), because the stage of the preparation of contracts is one of their main fields of application. III.–1:105 (Non-discrimination) clarifies that these rules apply not only in relation to contracts and juridical acts as such but also to obligations generally, including contractual, ‘post-contractual’ and non-contractual obligations, with appropriate modifications.

C. Discrimination on grounds other than ‘sex’ or ‘ethnic or racial origin’

The discrimination criteria ‘sex’ or ‘ethnic or racial origin’ are lifted from the two Directives which are applicable to the field of general contract law (and not just to labour contracts), i.e. the Antiracism Directive 2000/43/EC and the General Sex Discrimination Directive 2004/113/EC. Other grounds for discrimination which are also applicable in general contract law could be religion or belief, disability, age or sexual orientation (cf. Art. 13 EC-Treaty); colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status (cf. Art. 14 European Convention for the Protection of Human Rights and Fundamental Freedoms) or genetic features, language, religion or belief, political or any other opinion, membership of a national minority, property, birth, disability, age or sexual orientation (cf. Art. 21 EU Charter of Fundamental Rights). All these provisions are not directly applicable in general contract law. Hence, the particular remedies spelled out here in Chapter 2 of Book II are therefore not applicable to cases where discrimination occurs on the basis of these further criteria. This does, of course, not mean that such discrimination is allowed. Discrimination on grounds other than ‘sex’ or ‘ethnic or racial origin’ are to be taken into account when applying these model rules, in particular the rules on good faith and fair dealing. This follows from I.–1:102 (Interpretation and development) paragraph (2) according to which these rules are to be read in the light of any applicable instruments guaranteeing human rights and fundamental freedoms.

Another ground for discrimination, which may widely overlap with ‘race or ethnic origin’, is nationality (cf. Art. 12 of the EC-Treaty). But several Directives on non-discrimination exclude nationality from their scope of application (e.g. Art. 3(2) of the Antiracism Directive 2000/43/EC). The reason may be that the prohibition of discrimination on the ground of nationality in Art. 12 EC-Treaty can be seen as being directly applicable (cf. ECJ, 6 June 2000, C-281/98 – *Angonese*). Hence, Art. 12 EC-Treaty is a general principle of Community law and can therefore be invoked against any private person. But the EC-Treaty does not provide any sanctions for a violation of its Art. 12. Therefore it seemed more appropriate not to include discrimination on the ground of nationality into the system of remedies set out in these rules. In the (almost unimaginable) case of discrimination on the ground of nationality, which, at the same time, is not discrimination on the grounds of race or ethnic origin, the general rules, in particular I.–1:102 (Interpretation and development) paragraph (2), apply.

In the ECJ judgment of 22 November 2005, it is pointed out that “The principle of non-discrimination on grounds of age must thus be regarded as a general principle of Community law” (C-144/04 – *Mangold*). However, this statement can be read in connection with the preceding passage which primarily refers to the Directive on General Framework for Equal Treatment in Employment and Occupation. Even if the ECJ favours a broader understanding, expanding the prohibition of age related discrimination to all areas of private law, this would not solve the question of what the consequences of a violation of the prohibition should be. Hence, as in the case of Art. 12 of the EC-Treaty, these model rules do not provide a system of remedies for age discrimination.

Illustration 1

A group of citizens from one of the Member States books rooms in a hotel in a different Member State. The hotel refuses to perform its obligations under the contract, arguing that the citizens of this State are not welcome in the hotel. This type of discrimination is covered by Art. 12 of the EC-Treaty. From the perspective of this draft it also fulfils the conditions of discrimination based on ethnic origin. The notion of ethnic origin is sufficiently broad to also cover common citizenship.

It should be stated that in European law any kind of discrimination – for the reasons mentioned in Art. 12 and 13 of the EC-Treaty – is wrongful behaviour. It does not mean however that every instance of such behaviour will automatically amount to a violation of the law. The sanctioning of all possible kinds of discrimination in many different contexts would lead to conflict with other, often highly protected, values such as personal freedom, freedom of thought and freedom of contract. The current EC law shows an attempt by the law-maker to find a balance among all of these important values. The rules on non-discrimination are drafted with the idea of allowing easy modification and extension of the scope of its application in other areas of discrimination. The decision of whether such extension should happen is purely political.

D. Sex

Discrimination based on sex means that a person is treated by the other party differently from another person for the reason of being a man or a woman. The terminology suggested here is partially modelled on Art. 2 General Sex Discrimination Directive 2004/113/EC, which uses the term “sex” to describe the prohibited discrimination criteria. It might also have been possible to use the term “gender”, which refers to a social, cultural, or psychological condition, as opposed to that of biological sex. The terminology used by EC documents is not always consistent with regard to this distinction. Yet, as Art. 2 of the General Sex Discrimination Directive 2004/113/EC and Art. 2(1) (a) Directive on Principle of Equal Opportunities and Equal Treatment of Men and Women use the term “sex” in the definition of “direct discrimination”, these model rules follow this terminology.

E. Ethnic or racial origin

Discrimination based on ethnic origin means that a person is treated in a different way because that person, supposedly or actually, belongs to a group with a common tradition, culture or language. Discrimination based on race means that that person is treated differently because he or she, supposedly or actually, belongs to a specific race. The term “race” has to be understood in a subjective way, leaving it open to the discriminating persons to determine what they understand as being of a different “race”. Specifically, the use of the term “race” does not mean that these model rules accept any of the theories classifying people by race. However, one should acknowledge that the notion “race” cannot be purely understood in its subjective sense, i.e. from the perspective of the wrongdoer. A purely subjective criterion could lead to forbidden discrimination in any case where unequal treatment occurs due to the appearance of the person. Rather, discrimination based on race should be understood as relating to certain traits that, within a concrete cultural and social environment, are understood as a distinguishing criterion from the group of people to which a discriminator is believed to belong. It is necessary to evaluate each case with consideration to the local cultural and historical context and background.

Illustration 2

Landlord A refuses to rent an apartment to B for the reason that B has naturally red hair. A declares openly that he does not trust red-haired people. This example shows the difficulties in applying a purely subjective criterion of “race”. Generally it cannot be treated as discrimination based on racial reasons, unless there are some local contexts, which evidence that the local community treats “red-haired people” as strangers or some type of ‘other’.

Illustration 3

A shopkeeper refuses to sell bread to a customer, arguing that the buyer is Jewish. It is a clear case of racial discrimination, and it also follows a shameful tradition of discriminatory treatment of Jewish people as a different race. In this situation, it does not matter whether the client in fact belongs to the Jewish community or not. Legally, it is solely a question of evaluating the reason for the shopkeeper’s decision.

F. Access to goods and services available to the public

The right not to be discriminated against granted here is confined to contracts or other juridical acts which provide access to, or supply goods and services which are available, to the public. The notion of “goods and services”, which is taken from the Antiracism Directive 2000/43/EC and the General Sex Discrimination Directive 2004/113/EC, should have a similar meaning to that in these Directives. In addition it should also be interpreted in the light of Art. 23(1) EC-Treaty and Art. 50 EC-Treaty regarding the free movement of goods and services. The contracts must either be designed to transfer certain goods from the seller to the buyer, or to allow the customer to receive or make use of a service of the provider. The goods and services are available to the public if they are

typically offered in a general manner, irrespective of the person to whom the product is offered. This is precisely the case where goods or services are marketed to the public at large, for example, via an advertisement in the media or where goods and services are publicly offered by the owner of a shop or restaurant, regardless of whether this qualifies as an “offer” in the technical sense. Another example is the transport business, where the person of the contractual partner typically has no or little relevance.

Illustration 4

A one year contract to teach a foreign language has been concluded by the respective parties. A male student verbally violates the dignity of his female teacher because of her sex. This kind of contract is not covered by this Article because it is the supplier of the service and not the recipient who is discriminated against. Aside from this, the definition of harassment in II.–2:102 (Meaning of discrimination) paragraph (2) is fulfilled. Although this has the consequence that the remedies of this Chapter are not applicable, there may be other remedies. For example, the teacher may terminate the contractual relationship according to the rules on non-performance and might have a claim for damages under Book VI (Non-contractual Liability for Damage caused to Another).

II.–2:102: Meaning of discrimination

(1) “Discrimination” means any conduct whereby, or situation where, on grounds such as those mentioned in the preceding Article:

(a) one person is treated less favourably than another person is, has been or would be treated in a comparable situation; or

(b) an apparently neutral provision, criterion or practice would place one group of persons at a particular disadvantage when compared to a different group of persons.

(2) Discrimination also includes harassment on grounds such as those mentioned in the preceding Article. “Harassment” means unwanted conduct (including conduct of a sexual nature) which violates a person’s dignity, particularly when such conduct creates an intimidating, hostile, degrading, humiliating or offensive environment, or which aims to do so.

(3) Any instruction to discriminate also amounts to discrimination.

COMMENTS

A. Generic definition

Since the prohibited grounds for discrimination – ethnic or racial origin and sex – are already included in II.–2.101 (Right not to be discriminated against), there is no need to repeat them in the definition of the notion of discrimination. Therefore this Article provides a generic definition which also operates for other grounds of discrimination. The definition thereby underlines the idea that in principle all unequal treatment in a

comparable situation may amount to discrimination, although there is not a remedy for each sort of discrimination.

B. Direct and indirect discrimination

This Article is a synthesis of the definitions expressed by the non-discrimination Directives. It contains a definition of the term “discrimination” that covers both direct and indirect discrimination. In both cases the same remedies are available, and in both cases there is the possibility of justifying the unequal treatment (II.–2:103 (Exception)). Thus, these rules do not treat direct and indirect discrimination separately.

Generally, discrimination can be understood as meaning that a person is treated “less favourably than another person would be treated in a comparable situation”. Although the definition states that the unequal treatment must happen “on grounds” such as those mentioned in II.–2.101 (Right not to be discriminated against), no causal link between that reason and the treatment is required. Such a link would be very difficult to prove for the person discriminated against. According to II.–2:105 (Burden of proof) the person who considers himself or herself discriminated against on such grounds must merely establish the facts from which it may be presumed that there has actually been discrimination. In that case, it falls on the other party to prove that there has been no such discrimination.

Direct discrimination (paragraph (1)(a)) refers to a person being treated less favourably than another person would be treated in a comparable situation. The less favourable treatment means all treatment that disadvantages, such as rejecting the conclusion of a contract, not providing sufficient information, terminating a contractual relationship, requiring additional security or guarantees or additional services. A comparable situation is taken to mean a real or a potential situation of normal treatment of a person in similar circumstances subject to market conditions.

Illustration 1

A bank does not provide loans to coloured people. This is unequal treatment because the bank differentiates on the ground of race; white people who fulfil the other loan requirements would get the loan.

Illustration 2

A woman needs the additional signature of her husband in order to finance a lease, while a man could conclude that type of contract without his wife’s signature.

Illustration 3

A seller delivers goods to Roma people only against payment in advance, while other customers are able to get goods with a 14 day payment period after delivery.

The definition of indirect discrimination in paragraph (1)(b) tries to prevent the use of criteria that are not immanently linked to a specific group of people, but that could (proportionately) affect such a group more than another group of people.

Illustration 4

A bank grants loans only to full-time employees. Since most people who are employed in part-time jobs are women, such a policy of the bank is discriminatory.

C. Harassment

Paragraph (2) extends the notion of discrimination to two kinds of harassment: harassment in a broader sense and, in particular, sexual harassment. The harassment cases are not covered by the definition of discrimination under paragraph (1) because a harassed person is formally treated like others; yet such a person cannot enter into the transaction without being put into an intimidating or hostile or otherwise difficult or negative situation. The definition is modelled on the notion of harassment in Art. 2 (3) of the Directive on General Framework for Equal Treatment in Employment and Occupation 2006/54/EC, Art. 2 (3) of the Antiracism Directive 2000/43/EC and Art. (2)(c) of the General Sex Discrimination Directive 2004/113/EC. The inclusion of harassment cases in these rules on contract law can be justified by a need for coherence of the whole text on non-discrimination. In this case the proximity to the law on non-contractual liability for damage caused to another is evident.

Illustration 5

Racist music is played in a bar or restaurant. Such conduct violates human dignity and creates a humiliating and offensive environment.

Illustration 6

During a bus journey, a pornographic movie is being shown without the prior consent of the passengers. This constitutes sexual harassment because it may cause a degrading or humiliating situation for the passengers.

D. Instruction to discriminate

The term “discrimination” also includes an instruction to discriminate. The relation between the person acting in a discriminating way and the person discriminated against is of no relevance. Therefore, the prohibition of an instruction to discriminate could belong to the law on non-contractual liability. However, due to the close relationship to the whole system of non-discrimination, it has been included here. An “instruction to discriminate” means all orders to discriminate in the sense of paragraph (1) of this Article. An instruction to harass is also discrimination according to these rules.

Illustration 7

The manager of a barbershop orders his employees to stop providing services to coloured people.

II.-2:103: Exception

Unequal treatment which is justified by a legitimate aim does not amount to discrimination if the means used to achieve that aim are appropriate and necessary.

COMMENTS

A. General

This provision brings some necessary flexibility into the process of evaluating unequal treatment. It allows the justification of such treatment by legitimate aims. In this way, rational use of the freedom of contract, as long as it does not violate human dignity, is still granted. The rule also allows for different factors to be taken into account. It prevents the mechanical qualification of all unequal treatment as discrimination. The provision also allows specific measures to prevent or compensate disadvantages (positive discrimination), although these may constitute discrimination themselves.

B. No distinction between direct and indirect discrimination

II.-2:102 (Meaning of discrimination) does not distinguish between direct and indirect discrimination. This provision generalises the ideas expressed in Art. 4(5) of the General Sex Discrimination Directive 2004/113/EC. By contrast, the Antiracism Directive 2000/43/EC formulates the prohibition of direct discrimination on the grounds of race and ethnic origin as an absolute principle without any exception, whereas indirect discrimination in this Directive by definition also presupposes that there is no justified reason for the different treatment. II.-2:102 (Meaning of discrimination) does not follow the strict division between direct and indirect discrimination because it does not seem practical to maintain this distinction with regard to the requirements and effects of discrimination. Both the questions of whether there is discrimination, and of whether it could be justified, are a matter of evaluation, and their answers depend on its intensity as well as on a number of different facts. This approach also allows the law to justify and accept any ‘positive discrimination’ which is aimed at compensating or improving the position of disadvantaged people, often referred to as “reverse discrimination” or “affirmative action”.

The intention of this Article is therefore not to expand the possibilities of justification of unequal treatment, in particular in relation to the Antiracism Directive 2000/43/EC. The provision just merges different definitions and thereby reaches a higher level of abstraction. The consequence of such a synthesis is a reduction of the casuistic approach, which leads to the necessity of a more flexible interpretation and application. As this Article is an exception to the general prohibition of discrimination it has to be interpreted strictly. In the case of ethnically and racially based unequal treatment, only very exceptional circumstances may lead to the justification of such practices.

C. Justification by a legitimate aim

Unequal treatment may be justified by legitimate aims if the means applied to reach these aims are appropriate and necessary. The aims are legitimate, if they constitute a protected value in a society, which should not be surrendered. It could reflect the need to protect privacy, decency, religion or cultural identity. In exceptional cases (e.g. insurance contracts) certain economic factors can also provide justification. It is not sufficient, however, that such societal values are in conflict with the requirement of equal treatment. Rather, it must be decided whether the protection is of such value that it does not violate the main goal of non-discrimination laws: the protection of human dignity. The existence of a legitimate aim is not sufficient in itself. There needs to be proof that the unequal treatment is the only way to achieve this goal. The application of such a justification is tempered by the requirement of proportionality.

The fact that II.-2:102 (Meaning of discrimination) may apply to all cases of discrimination does not mean that the grounds on which discrimination occurs would not be relevant in deciding whether such discrimination can be justified. Depending on the kind of discrimination at hand, the exception test must be applied differently, i.e. more or less strictly. For instance, in the case of racial discrimination, the possibility of justification is extremely limited and absolutely exceptional, because of the overriding principle that the criterion of race should be abandoned as a means of classifying people. Since the criterion of race and, to some extent, that of ethnic origin are predominantly subjective categories, unequal treatment usually cannot bring real benefit worthy of justification. Therefore, only an exceptional justification test may be used when deciding whether to permit this kind of discrimination. The main example where unequal treatment on the ground of race or ethnic origin could be justified would be 'positive discrimination'. In case of any harassment (sexual or otherwise) there is no possible justification because of the reprehensibility of the very nature of such behaviour.

Illustration 1

A woman makes an offer to rent two rooms in her apartment, but only to female students. This discrimination can be justified for reasons of privacy and decency.

Illustration 2

A woman makes an offer to rent rooms in her apartment only to white students. This discrimination cannot be justified. Although there might be a legitimate privacy argument, this must not be based on or linked to the race of the roommates. One of the goals of non-discrimination law is to fight against unreasonable stereotypes. Race is such a stereotype that leads to degrading conditions for certain groups of people. Therefore, privacy motivations alone cannot be sufficient. Europe has an extremely painful history of racial discrimination. The memory of this history is reflected in constitutionally protected values, which must obviously influence which justifications for discrimination are permitted and which are not.

II.–2:104: Remedies

(1) If a person is discriminated against contrary to II.–2:101 (Right not to be discriminated against) then, without prejudice to any remedy which may be available under Book VI (Non-contractual Liability for Damage caused to Another), the remedies for non-performance of an obligation under Book III, Chapter 3 (including damages for economic and non-economic loss) are available.

(2) Any remedy granted must be proportionate to the injury or anticipated injury; the dissuasive effect of remedies may be taken into account.

COMMENTS

A. General

The provision indicates which sanctions apply for violation of the right not to be discriminated against. Sanctions serve to undo the results of discrimination and also to prevent further discrimination. Moreover, the effect should also be general prevention. According to the underlying Directives, the sanctions for discrimination must be effective, proportionate and dissuasive and entail the payment of damages for loss to the victim.

As II.–2.101 (Right not to be discriminated against) grants a right not to be discriminated against, an infringement of this right triggers the remedies for non-performance of an obligation under Book III, Chapter 3. Such remedies can be, in particular, the right to claim damages under Book III, Chapter 3, Section 7 or the right to terminate a contractual relationship under Book III, Chapter 3, Section 5. In exceptional cases, the remedy can also be a right to enforce performance under III.–3:302 (Non-monetary obligations), which may include the right to demand the conclusion of a contract.

B. Right to claim damages

The primary remedy for forbidden discrimination is the right to claim damages. Which persons are entitled to claim damages is a particularly controversial question. On the one hand, it would be going too far to grant this right to anyone who belongs to the discriminated group of persons. On the other hand, it would excessively restrict the right to damages if one required a person to actively try to enter into a contract with the discriminating person, even though the latter has made it clear that he or she will reject that attempt. It seems that a certain amount of proximity between the person who claims to be discriminated against and the discriminating situation or behaviour itself is a precondition to a right to claim damages. Otherwise the person will not be considered to have suffered loss, not even a non-economic loss. The question of who has a right to claim damages must be determined by bearing in mind that the remedies have to be effective, proportionate and dissuasive. Generally, a party to a contract, or at least a potential contractual partner, may be entitled to claim damages. It could, however, also be a person who is simply a customer and not a party to a contract or a potential contractual partner.

Illustration 1

A invites her boyfriend B, a person of colour, to a restaurant. The waiter does not want to serve B on racial grounds. In this situation, B is entitled to claim damages for non-economic loss even though he is not party to the contract.

Paragraph (1) of the Article clarifies that the right to claim damages for loss includes non-economic loss in the sense of III.-3:701 (Right to damages) paragraph (3). Because of the nature of discrimination, it may be extremely difficult in a large number of cases to prove that an economic loss has been suffered. Above all, discrimination violates human dignity. Therefore, it usually causes a non-economic loss.

Illustration 2

X, a credit institution, refuses to provide a loan to client B on the basis of B's ethnicity. B is forced to enter into a contract with another institution, Y, under less beneficial financial conditions. B has a right to claim damages for economic loss from X, which is the difference between the cost of the loan by institution Y and the costs of the loan by institution X. B may also have a right to claim damages for non-economic loss because of the violation of his dignity.

C. Right to terminate

Another remedy could be the termination of a contractual relationship, even if the contract does not allow such termination before the end of the regular duration of the contract.

Illustration 3

B, a person of colour, has, by contract, taken out a subscription to a newspaper. The newspaper unexpectedly publishes a series of articles presenting clearly racist positions. In this situation, B can terminate the contractual relationship because the criterion of harassment has been fulfilled.

D. Right to demand the conclusion of a contract

In exceptional cases, this Article in connection with III.-3:302 (Non-monetary obligations) can result in a right to demand the conclusion of a contract. Although such a remedy should not generally be excluded, it needs to be applied with the highest level of caution. It fundamentally infringes the principle of freedom of contract and is usually considered inefficient in the field of civil law contracts. Normally, a right to claim damages should be a sufficient means to satisfy the aggrieved party. In very specific situations, however, it is necessary to ensure that the victim of discrimination has access to the goods or services, where there has been a general denial to provide them on the basis of discrimination.

Illustration 4

A is a landlord who refuses to rent an apartment to a young pregnant woman, B, because specific protective measures exist which limit the ability to terminate contractual relationships with pregnant women. B may demand the conclusion of the contract with her. Since it is very likely that she will also face similar refusals from other people for the same reason, other remedies such as damages may not be sufficient to undo the effects of the discrimination.

Illustration 5

A seller refuses to sell food to a person of colour for racist reasons. Damages (also non-economic) should be a sufficient remedy, unless there are no other places to purchase food in the immediate or nearby area.

E. Other remedies, cumulation of remedies

The catalogue of remedies provided for in this Article is not exhaustive. There are various types of discrimination that could possibly occur in different situations, so that an adequate remedy has to be left to the circumstances. For instance, if a discriminating act occurred and will probably be repeated, it must also be possible to prohibit future discrimination. An exhaustive list of remedies could endanger the real possibility of undoing the consequences of discrimination. Other remedies for discrimination can be derived from many provisions of these model rules. Examples are II.–1:102 (Party autonomy), in particular, the rules on good faith and fair dealing, nullity of a contract under II.–7:301 (Contracts infringing fundamental principles), interpretation of a contract or implying a term in favour of a discriminated party under II.–8:102 (Relevant matters) sub-paragraph (g) or II.–9:101 (Terms of a contract), setting aside a contract term as being unfair under Chapter 9, Section 4 of Book II, the application of the rules on non-discrimination to all obligations, including ‘post-contractual’ and non-contractual obligations, under III.–1:105 (Non-discrimination) or remedies available under Book VI (Non-contractual Liability for Damage caused to Another).

Illustration 6

A is a landlord who rents apartments to tenants T1 to T4. Only the contract with T3, who is a person of colour, contains a provision according to which an additional guarantee payment is required to secure potential claims for damages. As this is a discriminatory clause, it is void under II.–7:301 (Contracts infringing fundamental principles).

All remedies can be combined, if appropriate. Save for cases of abuse of rights, a person who has been subjected to discrimination can choose from different remedies.

Illustration 7

If the victim is terminating a contractual relationship, the victim cannot at the same time require that the contract be modified, invalidating the discriminating clause(s). The victim may, however, simultaneously claim economic and non-economic damages.

F. Proportionality test and dissuasive effect

The remedies must be proportionate to the injury or anticipated injury. When applying this proportionality test, the particular situation of a person who has discriminated against others has to be taken into account, since the remedy must have a dissuasive effect. The dissuasive effect of sanctions plays its main role when non-economic loss is to be measured. The general policy function of the remedy, i.e. its dissuasive effect, must be taken into account. Consequently, the general rule on measure of damages in III.-3:702 (General measure of damages) has to be applied with a view to also give the remedy a dissuasive effect. In that sense, damages for non-economic loss may have a punitive element. Such damages are related to the specific kind of injury that has been suffered. When determining the amount of damages it should be borne in mind that the remedy must make any future acts of discrimination economically unattractive for the discriminating person. A dissuasive effect can only be achieved if the kind and size of the business belonging to the discriminating person is taken into consideration. The kind of discrimination and its degree of “intimidating power” should also be relevant. However, if the discriminatory act does not really affect the life conditions or real market opportunities of the person discriminated against, the amount of damages must not be disproportionate even when it has to be measured with a view to have a dissuasive effect.

Illustration 8

A large enterprise that provides hotel services only offers rooms with lower standards to certain ethnic groups. Each potential client from such ethnic groups, who was trying to rent a higher quality room and was refused to do so, may claim non-economic damages in a “significant” amount, which would reflect the enterprise’s position in the market.

Other remedies (apart from damages for economic and non-economic loss) must also be proportionate and dissuasive. In cases where the remedies directly relate to the modification of contract terms or the termination of a contractual relationship, the requirement of dissuasiveness has a limited scope of application. This simply means that the aggrieved party may also use stronger remedies than those needed to undo the consequences of discrimination, although the dissuasive purpose cannot lead to the abandonment of the requirement of proportionality. It follows that in particular cases, the termination of a contractual relationship may be granted although another remedy would be sufficient to undo the effects of discrimination, for example, a modification of the terms of the contract.

Illustration 9

In the case presented as Illustration 6, the tenant, instead of just declaring the discriminating contract clause void, terminates the entire contractual relationship. The remedy may apply, although the nullity of the clause would be sufficient to undo the effects of the discrimination.

II.-2:105: Burden of proof

(1) If a person who considers himself or herself discriminated against on one of the grounds mentioned in II.-2:101 (Right not to be discriminated against) establishes, before a court or another competent authority, facts from which it may be presumed that there has been such discrimination, it falls on the other party to prove that there has been no such discrimination.

(2) Paragraph (1) does not apply to proceedings in which it is for the court or another competent authority to investigate the facts of the case.

COMMENTS

A. General

The aim of paragraph (1) is to facilitate the requirement of proving the occurrence of the discriminatory act. Paragraph (2) does not change these rules. It only states that an investigating court or authority, acting ex officio, should also collect evidence which is in favour of the person allegedly acting in a discriminatory way. The provision is modelled along similar rules in EC law, e.g. in the Antiracism Directive 2000/43/EC and the General Sex Discrimination Directive 2004/113/EC.

B. Presumption

This provision does not entail a formal shift of the burden of proof, but it allows for the drawing of a conclusion from facts based on life experiences which indicate discrimination. It relaxes the rigidity of the law of evidence in favour of the person who claims to be discriminated against. The facts on which the presumption is based must be fully proved by this person. It must be facts which make the existence of discrimination likely according to the local practices, customs, or existing bias and traditional ideas. If such facts are proven the person who allegedly acted in a discriminatory way has the right to prove that there has not been such discrimination. This requires convincing the responsible court that the behaviour was motivated by – legitimate – grounds other than sex, race or ethnic origin.

Illustration

A landlord does not want to rent an apartment advertised in the press to an affluent Roma family. Because of the well known general problems faced by the members of Roma minorities, it is sufficient, at least in some Member States, to infer from the established fact alone that discrimination has occurred. In a situation where a landlord refuses to rent an apartment to a woman, this would by itself not be enough to give rise to a presumption of discrimination, unless in a specific country or region or local community such a sex-based refusal was common.

The burden of proof rule plays a crucial role in order to ensure the efficacy of anti-discrimination law. However, it is a highly controversial instrument, which in the context of civil law, is considered close to being an instrument allowing control over the

intentions and other thoughts of the alleged discriminator. Because of the ambivalence of the criterion for discrimination (in particular in cases of race) it is extremely difficult to determine the circumstances justifying the shift of the burden of proof.

C. Exception for ex officio inquisition proceedings

Paragraph (2) restates an exception from paragraph (1). The provision must be understood to mean that in such proceedings the alleged discriminator does not need to prove innocence. In such cases, the investigating authority has to collect the evidence proving all relevant circumstances, as well as evidence that is in favour of the respondent. It does not exclude the possibility, however, that conclusions or inferences can be made from the established facts. In this sense, presumptions based on paragraph (1) may also apply to proceedings in the sense of paragraph (2).

CHAPTER 3: MARKETING AND PRE-CONTRACTUAL DUTIES

Section 1: Information duties

II.-3:101: Duty to disclose information about goods and services

(1) Before the conclusion of a contract for the supply of goods or services by a business to another person, the business has a duty to disclose to the other person such information concerning the goods or services to be supplied as the other person can reasonably expect, taking into account the standards of quality and performance which would be normal under the circumstances.

(2) In assessing what information the other party can reasonably expect to be disclosed, the test to be applied, if the other party is also a business, is whether the failure to provide the information would deviate from good commercial practice.

COMMENTS

Illustration 1

Business A is the seller of a car, and B is the buyer. There are no problems with the car and it is of the quality normal for the type and make of car, and performs as normal. There is no duty under this Article on the seller to disclose any information.

However, if has information that the quality or performance of the goods or services to be provided will fall below the normal standard, then there is a duty to disclose this information to the other party.

Illustration 2

Business A is the seller of a car, and B is the buyer. A is aware that there is a problem with this car's engine when the car is driven for short distances only. This information would affect the level of quality and performance B could reasonably expect of a car of this type and make. A has a duty to disclose this information.

Illustration 3

Business A is the seller of a car, and B is the buyer. There are no problems with the car and it is of the quality normal for the type and make of car, and performs as normal. However, it is the previous season's model, and a new model is about to replace the model of the car to be sold within the next few days. If A knows this it must disclose this fact to the buyer.

Illustration 4

Business A is selling premises of a size suitable for a small shop to B. A knows that B plans to use them for a shop and also knows that according to municipal legislation the premises cannot be used for shop keeping. A should inform the buyer of this fact.

.-7:201 (Mistake)

II.-3:102: Specific duties for businesses marketing goods or services to consumers

(1) Where a business is marketing goods or services to a consumer, the business must, so far as is practicable having regard to all the circumstances and the limitations of the communication medium employed, provide such material information as the average consumer needs in the given context to take an informed decision on whether to conclude a contract.

(2) Where a business uses a commercial communication which gives the impression to consumers that it contains all the relevant information necessary to make a decision about concluding a contract, it must in fact contain all the relevant information. Where it is not already apparent from the context of the commercial communication, the information to be provided comprises:

- (a) the main characteristics of the goods or services, the identity and address, if relevant, of the business, the price, and any available right of withdrawal; and*
- (b) peculiarities related to payment, delivery, performance and complaint handling, if they depart from the requirements of professional diligence.*

COMMENTS

(Duty to disclose information about goods and services) sing and marketing information), which seeks to improve the rather unclear model of Art. 7 paragraph (4) of the Unfair Commercial Practices Directive 2005/29/EC. In a situation where a business uses commercial communication to draw the availability of particular goods or services to the consumer's attention, and the communication itself gives the impression to consumers that it contains all the relevant information necessary to make a decision about

concluding a contract, the commercial communication must in fact provide all the relevant information.

In such circumstances, some information will have to be given, provided that this is not already apparent from the communication. However, it does not apply to general marketing activities by a business, where it is clear that a consumer may have to take additional steps before it will be possible to acquire the goods or services, such as visiting a shop or a web-site.

B. Duty to provide material information

Paragraph (1) requires a business to give consumers “material” information. This provision is based on Art. 7(1) of the Unfair Commercial Practices Directive 2005/29/EC. Although Art. 7(1) of the Directive is formulated as a prohibition of omitting to provide material information; it seems that prohibition of an omission to provide information is equivalent to saying that there is a

Illustration 1

Business X markets ‘antique’ decoration telephones to consumers. Both II.–3:101 (Duty to disclose information about goods and services) paragraph (1) and paragraph (1) of the present Article require that X should provide information about the material fact that connecting these telephones to the telephone network is not allowed. According to paragraph (1) of the present Article, however, X should have provided this information in its marketing even before entering into any communication with a particular potential buyer.

Estee Lauder Cosmetics GmbH & Co. OHG v Lancaster Group GmbH and C-44/01 – *Pippig Augenoptik GmbH & Co. KG v Hartlauer Handelsgesellschaft GmbH*) and is also defined in the Preamble to the Unfair Commercial Practices Directive 2005/29/EC, Recital 18.

The duty to provide material information

In addition, if the practices of the business with regard to payment, delivery, performance and complaint handling depart from the requirements of professional diligence, then this must also be stated. The term “professional diligence”, which is derived from Art. 2(h) of the Unfair Commercial Practices Directive 2005/29/EC, relates to the standard of special skill and care which a business may reasonably be expected to exercise, measured with reference to honest market practice in the particular business sector, and good faith. In some situations, a business may offer a level of complaint handling which goes beyond this basic standard. Where this is the case, it is likely that a business would advertise this fact as part of its overall marketing strategy, and such information would therefore already be provided.

Paragraph (2) does not exclude the simultaneous application of paragraph (1), if its requirements are not fulfilled.

D. Sanctions for breach of information duties

The provision is derived from unfair commercial practices law (cf. Art. 7 Unfair Commercial Practices Directive 2005/29/EC), but it seems to have a useful role to play within the contract law framework as well. As it will be at least partially ‘consumed’ by II.–3:101 (Duty to disclose information about goods and services) in a situation when a contract is concluded, it will have its main role as a basis for damages under II.–3:107 (Remedies for breach of information duties) paragraph (2). However, as the information requirements according to this Article in some aspects go further than those of II.–3:101 (Duty to disclose information about goods and services), it may be used as a basis for contractual claims according to II.–3:107 (Remedies for breach of information duties) paragraph (3) as well.

Illustration 2

Business X, which markets ‘antique’ decoration telephones, omits in its marketing to inform consumers of the material fact that to connect these telephones to the telephone network is not allowed. Consumers who run up travel expenses for visiting X’s shop because of the marketing can claim damages for such costs under II.–3:107 (Remedies for breach of information duties) paragraph (2), even though they do not conclude any contract, having learnt about this feature.

II.–3:103: Duty to provide information when concluding contract with a consumer who is at a particular disadvantage

(1) In the case of transactions that place the consumer at a significant informational disadvantage because of the technical medium used for contracting, the physical distance between business and consumer, or the nature of the transaction, the business must, as appropriate in the circumstances, provide clear information about the main characteristics of the goods or services, the price including delivery charges, taxes and other costs, the address and identity of the business with which the consumer is transacting, the terms of the contract, the rights and obligations of both contracting parties, and any available right of withdrawal or redress procedures. This information must be provided a reasonable time before the conclusion of the contract. The information on the right of withdrawal must, as appropriate in the circumstances, also be adequate in the sense of II.–5:104 (Adequate notification of the right of withdrawal).

(2) Where more specific information duties are provided for specific situations, these take precedence over the general information duties under paragraph (1).

COMMENTS

transaction requiring that the informational disadvantage has to be significant.

The Article is further limited by linking the significant informational disadvantage to the technical medium used for entering into a contract; the physical distance between

business and consumer and the nature of the transaction. Therefore, it is not merely the existence of the significant informational disadvantage that activates the *Illustration 1*

S runs an on-line electronics store. C wishes to buy a washing machine and places an order over the internet. As C cannot inspect the washing machine before deciding to purchase, he is placed at a significant informational disadvantage. S is therefore required to provide information about the main characteristics of the washing machine, its price, including the cost of delivery, and other relevant information (including the existence of a right of withdrawal).

The nature of the transaction might also cause a significant informational imbalance; this will particularly be so in the case of high-value low-frequency transactions. An example is a contract for *Illustration 2*

C who knows very little about personal computers has gone to S's store to purchase a new laptop. C is at a significant informational disadvantage because she has very little information about computers. However, the disadvantage is not caused by the technical medium used, nor is there a physical distance between C and S, nor is the nature of the transaction itself the cause of the disadvantage. Consequently, there is no duty on S to provide information under this Article.

B. Categories of information

The Article lists a number of categories of information. These are expressed in very general terms, but they reflect the different items of information that have been required by the existing rules on pre-contractual information disclosure in the *acquis communautaire*. This generalisation is inspired by the provisions of the Unfair Commercial Practices Directive 2005/29/EC, where broad general categories similar to the ones listed in this Article are used. Existing legislation which requires the disclosure of information in particular situations frequently contains more detailed requirements. It is generally possible to group these requirements under the headings provided by the categories listed in this Article. For example, II.-3:103 refers to the "main characteristics of the goods or services". Under the Timeshare Directive 1994/47/EC, a business is required to provide a long list of particulars about the property subject to the timeshare contract. Many of these could be classed as relating to the main characteristics of the service provided. As regards the means of delivery. Also, where there are no "redress procedures" available, it may be desirable to at least provide an address to which a consumer may send. To provide information under all of the headings listed in the C.

Time and form of information

the consumer must be able to assess the relevance of the information provided for the decision whether or not to

With regard to the information on the right of withdrawal, the last sentence of this Article stipulates that such information must also be adequate in the sense of II.-5:104 (Adequate notification of the right to withdraw). Consequently, the existence of a right to withdraw has to be appropriately brought to the consumer's attention and must provide, in textual form on a durable medium and in clear and comprehensible language, information about how the right may be exercised, the withdrawal period, and the name and address of the person to whom the withdrawal is to be communicated.

The formal requirements applicable to the other information items mentioned are set out in II.-3:106 (Clarity and form of information) paragraph

II.-3:104: Information duties in direct and immediate distance communication

(1) When initiating direct and immediate distance communication with a consumer, a business must provide at the outset explicit information on its identity and the commercial purpose of the contact.

(2) Direct and immediate distance communication includes telephone and electronic means such as voice over internet protocol and internet related chat.

(3) The business bears the burden of proof that the consumer has received the information required under paragraph (1).

COMMENTS

and Art. 3(3)(a) of the Distance Selling of Financial Services Directive 2002/65/EC which both require businesses to disclose their identity and their commercial purposes when initiating certain kinds of direct and immediate distance communication with a consumer. The provision, which has the character of a market practices rule, 4(3) of the Distance Selling Directive 1997/7/EC stipulates the duty to disclose the identity and the commercial purpose of the communication only for “telephone communications”. The more recent Art. 3(3)(a) of the Distance Selling of Financial Services Directive 2002/65/EC uses the term “voice telephony communications”. This wording clarifies that the disclosure rule also applies to electronic means such as voice over internet protocol (“voice over IP”). What both traditional telephones and voice over IP communication have in common is that they involve a direct and immediate (“real time”) communication between the business and the consumer. Thus, instead of referring to individual communication technologies, paragraph Th

In order to make sure that the sanction for a violation of the disclosure rule is “effective, proportional and dissuasive” – as required e.g. by Art. 11 of the Distance Selling of Financial Services Directive 2002/65/EC – paragraph

II.-3:105: Formation by electronic means

(1) If a contract is to be concluded by electronic means and without individual communication, a business must provide information about the following matters before the other party makes or accepts an offer:

- (a) the technical steps which must be followed in order to conclude the contract;*
- (b) whether or not a contract document will be filed by the business and whether it will be accessible;*
- (c) the technical means for identifying and correcting input errors before the other party makes or accepts an offer;*
- (d) the languages offered for the conclusion of the contract;*
- (e) any contract terms used.*

(2) The contract terms referred to in paragraph (1)(e) must be available in textual form.

COMMENTS

The Article is broadly modelled on Art. 10 of the E-Commerce Directive 2000/31/EC. However, there are some notable deviations from the model. While Art. 10(1)(c) of the E-Commerce Directive 2000/31/EC requires information about technical means for identifying and correcting input errors “prior to the placing of the order”, under subparagraph (c) the information has to be given “before the other party makes or accepts an offer”. This change allows for the application of the rule without taking a position as to how the conclusion of the contract takes place, i.e. which party makes or accepts the offer.

Unlike Art. 10(2) E-Commerce Directive 2000/31/EC, the wording of this Article does not stipulate a duty of the business to indicate the relevant codes of conduct to which it has subscribed. An express reference to codes of conduct has been omitted in this Article mainly for two reasons. First, the Member States’ experience with Art. 10(2) E-Commerce Directive 2000/31/EC does not show clearly that the duty to indicate relevant codes of conduct does play an important role in legal practice across the European Union. Second, in those cases in which the specific provisions of a code of conduct are of importance for the contractual relationship, one can expect that these provisions will be referred to or even included in the contract itself. Consequently, in those cases reference to those terms will be covered by the disclosure duty provided by subparagraph (e).

C. Sanctions for breach of information duties

Remedies for breach of information duties(2) and (3). In addition, II.–3:106 (Clarity and form of information) specifies that a duty to provide information – including the duty established by this Article – is not fulfilled unless the information is clear and precise, and expressed in plain and intelligible language.

II.–3:106: Clarity and form of information

(1) A duty to provide information imposed on a business under this Chapter is not fulfilled unless the information is clear and precise, and expressed in plain and intelligible language.

(2) Rules for specific contracts may require information to be provided on a durable medium or in another particular form.

(3) In the case of contracts between a business and a consumer concluded at a distance, information about the main characteristics of the goods or services, the price including delivery charges, taxes and other costs, the address and identity of the business with which the consumer is transacting, the terms of the contract, the rights and obligations of both contracting parties, and any available redress procedures, as may be appropriate in the particular case, need to be confirmed in textual form on a durable medium at the time of conclusion of the contract. The information on the right of withdrawal must also be adequate in the sense of II.–5:104 (Adequate notification of the right to withdraw).

(4) Failure to observe a particular form will have the same consequences as breach of information duties.

COMMENTS

, reasonably, avoid leaving room for different interpretations. In addition, the language used must be plain and intelligible. This means that technical language should be avoided as much as possible. Where such language has to be used, it should be explained adequately.

Illustration 1

Company S operates a website for selling laptops on-line. It is required (under II.–3:105 (Formation by electronic means)) to provide a consumer with certain items of information. In giving this information, S needs to ensure that the information is clear and precise. For example, a statement about the cost of supplying a laptop along the lines of “€ 499.99, with additional tax and delivery charges as notified in our standard terms and conditions” is insufficiently clear and precise, whereas a statement that supplying the laptop “costs € 549.99 (including all taxes and delivery costs)” would be acceptable.

such information has to be provided on a durable medium or in another particular form. It is not a general requirement that information always has to be provided in a particular form, but this may be needed for specific contracts. Paragraph (3) provides an example of such a rule stipulating that specific information items required for distance contracts need to be confirmed in textual form on a durable medium at the time of the conclusion of the contract.

D. Sanctions for breach of form requirements

As far as the consequences of a breach of particular form requirements for information duties are concerned, paragraph (4) states that these are the same as for breach of the information duties themselves. However, the consequences may nevertheless be different for damages because of the causation requirement – the loss for which damages are claimed must have been caused by the incorrect or missing information, or the fact that information was not provided in the correct form. But the losses caused by having information in an incorrect form may not be the same as not having received the information in question at all.

It must also be noted that there may be additional consequences, because a failure to observe the correct form may trigger additional rights, such as withdrawal from the contract, or termination

II.–3:107: Remedies for breach of information duties

(1) If a business is required under II.–3:103 (Duty to provide information when concluding contract with a consumer who is at a particular disadvantage) to provide information to a consumer before the conclusion of a contract from which the consumer

has the right to withdraw, the withdrawal period does not commence until all this information has been provided. Regardless of this, the right of withdrawal lapses after one year from the time of the conclusion of the contract.

(2) Whether or not a contract is concluded, a business which has failed to comply with any duty imposed by the preceding Articles of this Section is liable for any loss caused to the other party to the transaction by such failure

(3) If a business has failed to comply with any duty imposed by the preceding Articles of this Section and a contract has been concluded, the business has such obligations under the contract as the other party has reasonably expected as a consequence of the absence or incorrectness of the information. Remedies provided under Book III, Chapter 3 apply to non-performance of these obligations.

(4) The remedies provided under this Article are without prejudice to any remedy which may be available under II.–7:201 (Mistake).

(5) In relations between a business and a consumer the parties may not, to the detriment of the consumer, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

damages for loss caused by the failure to inform (paragraph (2)). Thirdly, the failure to provide information may also affect the substance of the obligations assumed under the contract and may result in the incorrect performance or non-performance of contractual obligations (paragraph (3)). Finally, it is made clear by paragraph (4) that remedies for mistake are not affected. Under II.–7:201 (Mistake) paragraph (1)(b)(iii) a party may be able to avoid a contract for mistake if the other party caused the contract to be concluded in error by failing to comply with a pre-contractual information duty.

B. Prolongation of the right to withdraw

Paragraph (1) is based on several provisions in the Acquis communautaire that provide for the prolongation of an existing right of withdrawal in case of a violation of certain information duties (cf. Art. 5 Doorstep Selling Directive 1985/577/EEC, Art. 5(1) Timeshare Directive 1994/47/EC, Art. 6 Distance Selling Directive 1997/7/EC and Art. 6(1) Financial Services Distance Selling Directive 2002/65/EC). Reflecting these provisions, paragraph (1) of this Article states that in case of a violation of the information duty under II.–3:103 (Duty to provide information when concluding One of the more thorny issues in this context is whether the commencement of the withdrawal period is extended indefinitely or whether there sh established that the prolongation of the withdrawal period because of a violation of information duties under certain Directives which do not provide for a clear long-stop may be unrestricted (C-481/99 – *Heininger v Bayerische Hypotheken- und Wechselbank*). However, the second sentence of paragraph t to of damages that might be recoverable, and if a claim would arise in contract or (damages for negligent negotiations) may need to be drawn. Case C-334/00 – *Fonderie Officine Meccaniche Tacconi Spa v Heinrich Wagner Sinto Maschinenfabrik GmbH*, a case from Italy involving a claim for wrongfully breaking-off negotiations regarding a

contract, the ECJ took the view that this kind of action was a “matter relating to tort” for the purposes of the Brussels Convention.

D. Consequences for the substance of the contract

Paragraph (3) reflects the general idea that information available in the pre-contractual context can have a bearing on the substance of a contract. Thus, if a contract has been concluded, failure to provide the required pre-contractual information, or to use the correct form, can affect the substance of the obligations assumed under the contract, and may result in the incorrect performance or non-performance of contractual obligations.

E. Relation to other provisions

The remedies available for breach of pre-contractual information duties are partially found in other parts of contract law, related both to business-to-consumer relations as well as to other contractual relationships. In some situations an omission to give information can be misleading in a way that makes the general provisions on validity of contracts or unfair contract terms applicable. Failure to comply with the duties in this Section may have consequences within existing validity rules, e.g. when establishing whether there has been legal intention, fraud, etc, although those consequences may not amount to remedies in the strict sense.

In other situations the omission can lead to such a difference between the other party’s expectations and the actual performance that remedies for may be available. In particular, if the omission to provide information leads to a situation in which the other party concludes a contract misinformed about some relevant fact, this party in a contract of sale has the ordinary remedies for lack of conformity.

Section 2: Duty to prevent input errors

II.–3:201: Correction of input errors

(1) A business which intends to conclude a contract by making available electronic means without individual communication for concluding it, must make available to the other party appropriate, effective and accessible technical means for identifying and correcting input errors before the other party makes or accepts an offer.

(2) Where a person concludes a contract in error because of a failure by a business to comply with the duty under paragraph (1) the business is liable for any loss caused to that person by such failure. This is without prejudice to any remedy which may be available under II.–7:201 (Mistake).

(3) In relations between a business and a consumer the parties may not, to the detriment of the consumer, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

11(2) of the E-Commerce Directive 2000/31/EC requires that technical means for identifying and correcting input errors have to be provided “prior to the placing of the order”. In contrast, the above Article states that such technical means have to be available “before the other party makes or accepts an offer”. This change of wording allows for the application of the rule without taking a preconceived position as to how the conclusion of the contract takes place, i.e. which party makes or accepts the offer.

According to paragraph (3), in relations between businesses and consumers, the Article is mandatory in favour of a consumer.

B. Sanctions and relation to other provisions.

The E-Commerce Directive 2000/31/EC does not provide for a clear sanction for the breach of the duty under its Art. 11 and leaves the determination of sanctions to the Member States. In contrast, paragraph (2) of the states that the business is liable for any loss caused to the other party because of the erroneous conclusion of a contract due to the business’s failure to comply with subThis is without prejudice to any remedy which may be available under II.–7:201 (Mistake). Under II.–7:201 (Mistake) paragraph (1)(b)(iii) a party may be able to avoid a contract for mistake if the other party caused the contract to be concluded in error by failing to comply with a duty to make available a means of correcting input errors.

Th (Formation by electronic means) paragraph (1)which requires businesses to provide information about the technical means for identifying and correcting input errors.

Section 3: Negotiation and confidentiality duties

II.–3:301: Negotiations contrary to good faith and fair dealing

- (1) A person is free to negotiate and is not liable for failure to reach an agreement.*
- (2) A person who is engaged in negotiations has a duty to negotiate in accordance with good faith and fair dealing. This duty may not be excluded or limited by contract.*
- (3) A person who has negotiated or broken off negotiations contrary to good faith and fair dealing is liable for any loss caused to the other party to the negotiations.*
- (4) It is contrary to good faith and fair dealing, in particular, for a person to enter into or continue negotiations with no real intention of reaching an agreement with the other party.*

COMMENTS

A. The subject matter

In trying to obtain a contract a person may commit fraud or make misrepresentations or threats. For such behaviour the person may become liable in damages whether there is a valid contract or not. The question of validity is dealt with later.

The present Article deals primarily with the duty to negotiate in accordance with good faith and fair dealing and with the liability of a party to negotiations for harm caused to the other party by entering into or continuing negotiations with the intention not to make a contract or by breaking off negotiations contrary to good faith and fair dealing.

B. Freedom to negotiate and to break off

Apart from cases where the law imposes a duty to make certain contracts, or at least prevents the selection of a contracting partner in a discriminatory fashion (see Chapter 2 (Non-Discrimination), a person is free to decide whether or not to enter into negotiations and whether or not to conclude a contract. This principle is restated in paragraph (1), which sets the scene for the rest of the Article. A person may enter into negotiations even though uncertain as to whether a contract will result. A person may break off the negotiations, and does not have to disclose why they were broken off. Shopkeepers and other sellers will generally have to accept that people inspect their goods and ask for prices and other terms without buying. The same applies to lessors and sellers of apartments and houses who invite inspection of the premises.

C. Freedom qualified by duty

The freedom stated in paragraph (1) is qualified by the duty, set out in paragraph (2), to negotiate in accordance with good faith and fair dealing. The duty may not be excluded or limited by contract. It will be noted that this is a duty, not an obligation. The remedies for non-performance of an obligation are not all available. In particular, the remedy of specific performance is not available: it could be impracticable to try to enforce specifically a duty to negotiate fairly and in good faith. The remedies of withholding performance of reciprocal obligations and termination of reciprocal obligations are also unavailable. This means that, for example, breach by one party of the duty to negotiate in accordance with good faith and fair dealing does not entitle the other to disregard his or her reciprocal duty. However, breach of the duty may give rise to a liability for damages under paragraph (3).

D. Entering into negotiations contrary to good faith

A person, and especially a professional, who enters into negotiations knowing that they will never result in a contract may be held liable to the other party if the other, in negotiating in vain, incurred significant costs.

Illustration 1

A, who lives in England, applies for a senior post at B's factory in Spain. B has offered to pay travel expenses for attending an interview. A never has any intention of taking the job, but simply wants a free trip to Spain in order to visit a friend. B pays A's travel expenses but later learns the truth. A is liable to B for the costs B incurred in paying for A's travel.

E. Continuing negotiations contrary to good faith

There may also be liability for continuing negotiations after one has decided not to conclude the contract.

Illustration 2

The facts are the same as in Illustration 1 except that when starting the negotiations A did intend to take the job if it seemed suitable. The decision not to accept any offer of a post with B was made after the first interview. However, in order to get a second free trip A pretends to be interested in attending a second more intensive interview and gets travel expenses for that. B then learns the truth. A is liable to B for the costs incurred by B in paying for the second lot of travel expenses.

F. Breaking off negotiations contrary to good faith

A person may incur liability for breaking off negotiations contrary to good faith and fair dealing.

Illustration 3

B has offered to write a software programme for A's production. During the negotiations B incurs considerable expenses in supplying A with drafts, calculations and other written documentation. Shortly before the conclusion of the contract is expected to take place, A invites C, who can use the information supplied by B, to make a bid for the programme, and C makes a lower bid than the one made by B. A then breaks off the negotiations with B and concludes a contract with C. A is liable to B for the expenses incurred by B in preparing the documentation.

G. Basis of liability

Liability may be based on misrepresentation: see Illustrations 1 and 2 where A led B to believe that he intended to conclude a contract. Such misrepresentation may give rise to a right to damages under Book VI (Non-contractual Liability arising out of Damage caused to Another) but the present Article provides an alternative basis of claim. Liability may also be imposed because a party gave promises during the negotiations.

Illustration 4

A assures B that B will obtain a franchise to operate a grocery store as one of A's franchisees. The conditions are that B invest a stated amount and acquire some experience. In order to prepare herself for the franchise B sells her bakery store,

moves to another town, and buys a lot. The negotiations, which last over two years, finally collapse when A charges a substantially larger financial contribution than the one originally contemplated, and B finds herself unable to make this contribution. Although there is no evidence that the promises originally made by A were made contrary to good faith, A's breach of these promises is contrary to good faith, and A will be held liable to B for the losses B suffered in preparing for the franchise.

H. Heads of damages

The losses for which the person who acted contrary to good faith is liable include expenses incurred (Illustration 1), work done (Illustration 3) and loss on transactions made in reliance of the expected contract (Illustration 4). In some cases loss of opportunities may also be compensated. However, the aggrieved party cannot claim to be put into the position in which that party would have been if the contract had been duly concluded and if the obligations under it had been duly performed.

Illustration 5

Weare, a company which manufactures clothes, is about to order material of a registered design from Cloth, a company which owns the copyright. Another company, Scham, falsely claims that it owns the copyright and offers to supply the material to Weare at a lower price than Cloth has offered. By the time Weare discovers that Scham does not own the copyright and cannot sell the material, Weare has lost the chance to sell the dresses it intended to make from the material. Weare, which has not made any contract with Scham, may claim damages for lost opportunity and wasted expenses from Scham, but not the amount Weare would have saved by paying the lower price which Scham had offered.

II.-3:302: Breach of confidentiality

(1) If confidential information is given by one party in the course of negotiations, the other party is under a duty not to disclose that information or use it for that party's own purposes whether or not a contract is subsequently concluded.

(2) In this Article, "confidential information" means information which, either from its nature or the circumstances in which it was obtained, the party receiving the information knows or could reasonably be expected to know is confidential to the other party.

(3) A party who reasonably anticipates a breach of the duty may obtain a court order prohibiting it.

(4) A party who is in breach of the duty is liable to pay damages to the other party for any loss caused by the breach and may be ordered to pay over to the other party any benefit obtained by the breach.

COMMENTS

A. No general duty of confidentiality

Parties who negotiate a contract have in general no obligation to treat the information they have received during the negotiations as confidential. Should there be no contract, the recipient may disclose the information to others, and may make use it.

B. Confidential information

A party, however, may be interested in confidentiality and may expressly declare that information given is to be kept secret, and may not be used by the other party. Further, when no such declaration is made, the receiving party may be under an implied duty to treat certain information as confidential. This implied duty may arise from the special character of the information, and from the parties' professional status. The other party knows or can reasonably be expected to know that this information is confidential. It will be contrary to good faith and fair dealing to disclose it or to use it for the recipient's own purpose if no contract is concluded.

Illustration

A has offered to acquire B's know-how for the use of special plastic bags in the dyeing industry. During negotiations B must give A some information about the essential features of the know-how in order to enable A to assess its value. Although B has not expressly requested A to treat the information given as confidential, B has sent the written documentation to A at A's personal address and by registered mail, and B has only talked to A about it when they were alone.

A has a duty to treat the information given as confidential. A may not disclose it to others. Should there be no contract, the information may not be used for A's own purposes.

C. Rights and remedies

In relation to breach of confidentiality prevention is often more important than the recovery of damages. This is reflected in paragraph (3). Paragraph (4) gives a right to damages for any loss caused by a breach. The injured party may also be entitled to recover the benefit which the person in breach has received by disclosing the information or by using it even if that party has not suffered any loss. Although this remedy is not provided by the laws of all the Member States, it seems appropriate by analogy to remedies available for infringement of other intellectual property rights.

Section 4: Unsolicited goods or services

II.-3:401 No obligation arising from failure to respond

(1) If a business delivers unsolicited goods to, or performs unsolicited services for, a consumer:

(a) no contract arises from the consumer's failure to respond or from any other action or inaction by the consumer in relation to the goods and services; and

(b) no non-contractual obligation arises from the consumer's acquisition, retention, rejection or use of the goods or receipt of benefit from the services.

(2) Sub-paragraph (b) of the preceding paragraph does not apply if the goods or services were supplied:

(a) by way of benevolent intervention in another's affairs; or

(b) in error or in such other circumstances that there is a right to reversal of an unjustified enrichment.

(3) This Article is subject to the rules on delivery of excess quantity under a contract for the sale of goods.

COMMENTS

A. Purpose

The purpose of this Article is to protect consumers from an unwanted marketing technique, the unsolicited delivery of goods or provision of services. It should help to promote correct behaviour by the threat of a private law sanction. As the provision seeks to avoid an aggressive practice, there is in principle no reason to protect the position of the business. The present Article may even be partially just affirmative, as it should anyway follow from the general rules on the formation of contracts (Book II Chapter 4) or on unjustified enrichment (Book VII) that in most cases the business cannot claim anything from the consumer on the basis of such selling methods. But following the model of the Distance Selling Directives 1997/7/EC and 2002/65/EC, the Article expressly makes it clear that no contract arises and that no non-contractual obligation arises except in genuine cases of unjustified enrichment (e.g. delivery in error) or benevolent intervention. The Article deliberately leaves open, whether the ownership of goods passes to the consumer in case of the unsolicited provision of goods. This question will be regulated in Book VIII on the Acquisition and Loss of Ownership in Movables.

B. Goods and services in business to consumer relations

The rule concerns both the supply of goods as well as the provision of services by a business to a consumer. This scope of application, in particular the limitation to business to consumer relations (B2C), reflects the situation in EC law. This limitation does not support an e contrario conclusion that the unsolicited delivery of goods or provision of services is allowed between businesses in any case.

C. Unsolicited

The delivery of goods or provision of services must be unsolicited. This is not the case where, prior to the supply of the goods or the provision of the services, the consumer has ordered them. If the consumer has made a request which did not amount to an offer in the sense of II.-4:201 (Offer) and the business in response thereto delivered the goods or services in question together with an offer, it is not always clear whether the goods or services are unsolicited. In such cases, the goods or services are not unsolicited if the consumer knew or ought to have known in the circumstances that, in response to the request, the business would link its offer with the delivery of the goods. If a contract has already been concluded between consumer and business, but has subsequently been avoided, the goods or services originally ordered do not thereby become unsolicited. It is also not regarded as an unsolicited supply if the business has supplied goods or provided services which are different from those ordered, but which are similar in terms of price and value, and if the business thereby makes clear that the consumer is not obliged to accept them and does not have to bear the costs of return. In such circumstances the consumer does not require the protection provided under the present Article.

D. Benevolent intervention, error, excess quantity

Paragraph (2) clarifies some further exceptions from the rigid rule of paragraph (1) with regard to non-contractual obligations. These exceptions are justified because they cover cases where the business clearly is not using an unwanted marketing technique. Benevolent intervention may occur, in particular with regard to services, in emergency situations where non-contractual claims should not be excluded. Where the unsolicited delivery of goods or provision of services is just the consequence of an error (which the business will have to prove) it would be inappropriate to exclude all non-contractual claims. It should be noted that paragraph (2) does not for itself grant any claim to the business. It just does not exclude non-contractual claims arising from Book V (Benevolent Intervention) or Book VII (Unjustified Enrichment). Paragraph (3) regulates the relationship of the present Article with the more specific provisions in IV.A.-3:302 (Early delivery and delivery of excess quantity).

Illustration 1

Consumer B has ordered a men's wrist watch from business A. By mistake, business A sends a ladies' wrist watch to B. B assumes that A has made a mistake and throws the ladies' wrist watch away. In this case, the present Article does not – according to the purpose of the rule (to prevent improper market behaviour) – catch the behaviour of A, as A has sent B the wrist watch in response to the latter's order and has thus acted in the context of acceptable market behaviour, but has merely made a mistake. The present Article therefore does not apply; thus the business may have a claim based on unjustified enrichment and – if applicable – for damages under the general rules.

Illustration 2

Consumer B has ordered a men's wrist watch for €50 from business A. A intentionally sends B a different, higher value model and, without any further explanation, invoices him for €200 . This case concerns the supply of unsolicited goods. B is under no obligation to pay for the product or to return it.

E. No contract

Paragraph (1)(a) is just affirmative. In the case of unsolicited goods or services, it follows from the general rules on the formation of contract that no contract is concluded as long as the consumer does not respond. This applies in all cases, whether the goods or services were supplied deliberately or by mistake. Mere silence by the consumer is not to be regarded as offer or acceptance. The rule excludes any obligation on the part of the consumer arising from his or her failure to respond. If the consumer does not state that he or she wishes to conclude a contract, no contract is concluded. This also applies if the consumer makes use of the goods supplied or disposes of them, if no other circumstances clearly show that the consumer intends to conclude a contract with the business. All claims which are based on the existence of a contract are excluded. This also includes, in addition to the claim for payment of the price for the goods or service, all contractual claims for non-performance and remedies associated therewith (e.g. damages). No contract based on conduct arises between consumer and business.

Illustration 3

Business A sends consumer B a product together with a statement that, if B does not object, then B will be billed for the product in two weeks time. B does nothing and receives a bill from A after two weeks. B is under no obligation to pay for the product.

Illustration 4

The facts are the same as in Illustration 3, except that B, without making any statement towards B, has used the product a few times. The mere use of the product by B is not to be regarded as an acceptance of A's offer; a contract has therefore not been concluded. B is under no obligation to pay for the product. Neither need B pay any damages for use of the product.

F. No non-contractual obligations

The main field of application of this Article could be paragraph (1)(b) which states that no non-contractual obligation arises from the consumer's acquisition, retention, rejection or use of the goods or receipt of benefit from the services. The provision clearly seeks to have a dissuasive effect on businesses which want to use this marketing technique. The consumer does not need to return the goods or keep them or in any way treat them with care. Paragraph (1)(b) therefore excludes all claims against the consumer for restitution for use and for value, provided they relate to the unsolicited goods or services, irrespective of whether such claims are based on unjustified enrichment, non-contractual liability for damage or property rights, and irrespective of whether the consumer behaved negligently or deliberately. Also restitutionary claims based on property law (*rei*

vindicatio) are excluded. The provision does not deal not with the question whether the recipient of unsolicited goods becomes owner of them – either immediately on non-rejection or after a certain period of time if they are not reclaimed. But the rules in a future Book VIII on the Acquisition and Loss of Ownership in Movables may have this effect.

Illustration 5

The facts are the same as in Illustration 3, except that one week later B dumps the product in a rubbish bin. B is under no obligation to pay damages to business A.

G. Claims against the sender of unsolicited goods

The present Article does not regulate possible claims of the recipient against the supplier of the unsolicited goods or services. If the recipient returns the unsolicited goods, the costs of return may have to be borne by the supplier under the rules of Book V (Benevolent intervention). However, the recipient should be expected to communicate with the supplier before sending the goods back at the supplier's expense. In the rare case where the recipient cannot contact the supplier and comes to the reasonable conclusion that the supplier would want to have the goods back, then the rules on benevolent intervention would apply and there would be a right to reimbursement of the expenditure on sending the goods back. The situation may be similar in the – probably rare – case that the recipient has to incur specific costs for the disposal of the goods. The recipient can recover any price already paid in error under the rules of Book VIII (Unjustified enrichment).

CHAPTER 4: FORMATION

Section 1: General provisions

II.-4:101: Requirements for the conclusion of a contract

A contract is concluded, without any further requirement, if the parties:

- (a) intend to enter into a binding legal relationship or bring about some other legal effect; and*
- (b) reach a sufficient agreement.*

COMMENTS

A. Contract

In these rules the notion of a contract covers any agreement between two or more parties which gives rise to, or is intended to give rise to, a binding legal relationship or to have some other legal effect, such as the modification or termination of existing rights or

obligations or the immediate assignment or waiver of a right. The notion of a contract includes not only cases where both parties have reciprocal rights and obligations but also cases where only one party has obligations. The present Article is concerned not with defining a contract but with stating the requirements for the conclusion of a contract.

The basic requirements for the conclusion of a contract are that the parties have an intention to enter into a binding legal relationship or bring about some other legal effect and reach a sufficient agreement.

B. Parties

For there to be a contract there must be two or more parties. A contract is a bilateral or multilateral juridical act. Under these rules, unilateral juridical acts of various types, including promises intended to be binding without acceptance, may produce legal effects but they are not contracts.

C. Intention

The requirement of an intention to enter into a binding legal relationship or bring about some other legal effect serves to distinguish a contract from such agreements as mere social engagements or mere provisional understandings reached in the course of negotiations. It also leaves it open to parties, if they prefer, to make it clear that they are operating under an agreement or arrangement which is not intended to be a legally binding contract.

It is not necessary that both parties must intend to incur obligations under the contract. They both must intend to enter into a binding legal relationship or to bring about some binding legal result but there could be a contract even although only one party had obligations under it. There could also be a contract even if the intention was to bring about a binding legal result immediately and directly without the intervention of any obligation to do so by a further step.

A party's intention is for this purpose to be ascertained from the party's statements or conduct as reasonably understood by the other party. See the following Article.

D. Sufficient agreement

The requirement of an agreement serves to distinguish a contract not only from unconcluded negotiations which have not yet led to agreement but also from a unilateral juridical act where there is no agreement between two or more parties.

The agreement may be reached by one party's acceptance of the other's offer, by the parties' assent to terms which have been drafted by a third party, or in other ways. An acceptance may be express or may be by doing an act or suffering a forbearance asked for by the offeror.

There must be agreement but a very vague and general agreement might not be enough for there to be a contract. The agreement must also be “sufficient” – that is to say, it must have sufficient content.

E. No further requirement

The existence of two or more parties, the relevant intention of the parties and sufficient agreement between the parties are enough. There are no further requirements. No form is required, save in exceptional cases where this is provided for expressly. Nor is it necessary that one party undertakes to furnish or furnishes something of value in exchange for the other party’s undertakings (consideration). Unlike the laws of some Member States, these model rules do not require consideration or *cause*, nor do they require that to create certain contracts, property must be handed over to the party who is to receive it (real contracts). The additional requirements (which in many cases are attenuated or are readily evaded) do not seem to fulfil a sufficiently important function to be desirable elements of a modern model for contract law. Any residual functions of consideration or *cause*, such as preventing very one-sided agreements from being enforceable, are fulfilled by other rules, such as II.–7:207 (Unfair exploitation).

The fact that there is no further requirement for the formation of a contract does not mean that a contract, once formed, may not be invalid because of some defect of consent or illegality. These topics are dealt with later (see Chapter 7 (Grounds of Invalidity)).

II.–4:102: How intention is determined

The intention of a party to enter into a binding legal relationship or bring about some other legal effect is to be determined from the party’s statements or conduct as they were reasonably understood by the other party.

COMMENTS

A. Intention

Parties often make preliminary statements which precede the conclusion of a contract but which do not indicate any intention to be bound at that stage. The parties to an arrangement may also make statements which attempt to make it clear that they will be morally but not legally bound. It will often be necessary to interpret such statements. It can, for example, be difficult to distinguish between a non-binding letter of intent or letter of comfort and a letter which is intended to be legally binding and which, if accepted, will lead to a contract

Illustration 1

When a subsidiary company asked a bank to grant it a loan of €8 million, the bank asked the parent company to guarantee the loan. The parent company refused, but gave a letter of comfort instead. This read: “It is our policy to ensure that the

business of (the subsidiary) is at all times in a position to meet its liabilities to you under the loan facility arrangement". The letter also stated that the parent company would not reduce their financial interests in the subsidiary company until the loan had been repaid. When during the negotiations the bank learned that a letter of comfort would be issued rather than a guarantee, its response was that it would probably have to charge a higher rate of interest. When later the subsidiary company went into liquidation without having paid, the bank brought an action against the parent company to recover the amount owing. The action failed since the parent company's statements made it clear that it did not intend to be legally bound.

A party's statement is sometimes an invitation to one or more other parties to make an offer. Such an invitation is not meant to bind the party which makes it. It may, however, produce effects later if it has provoked an offer and acceptance which refer to the terms stated in the invitation.

B. The appearance of intention

The Article provides that the intention of a party to enter into a binding legal relationship or bring about some other legal effect is to be determined from the party's statements or conduct as they were reasonably understood by the other party. This is consistent with the normal rule on the interpretation of unilateral juridical acts.

This represents the law in many (probably the majority) of Member States. Others maintain their traditional position that a party who can prove that, despite an apparent intention, there was no actual intention to contract will not be liable in contract; but even in these laws the party will normally be liable on some other basis for having carelessly misled the other party. It seems better for the model rules to follow the first approach and hold a party liable on the basis of what reasonably appeared to the other party to be an intention to be bound or to produce some other legal effect.

C. Silence or inactivity

Silence or inactivity will generally not bind a person. However, specific exceptions from this rule are provided in several later Articles.

II.-4:103: Sufficient agreement

(1) Agreement is sufficient if:

- (a) the terms of the contract have been sufficiently defined by the parties for the contract to be given effect; or*
- (b) the terms of the contract, or the rights and obligations of the parties under it, can be otherwise sufficiently determined for the contract to be given effect.*

(2) If one of the parties refuses to conclude a contract unless the parties have agreed on some specific matter, there is no contract unless agreement on that matter has been reached.

COMMENTS

A. Sufficient content to agreement

For there to be a contract there must be agreement and there must be a sufficient content to the agreement. The parties could draw up very full and precise terms in a written document but there would be no contract until they had agreed to be bound. If the contract was to be concluded by signatures, then there would only be a draft contract until the parties signed. However, agreement by itself is not enough. There must also be a sufficient content to the agreement. A vague and general agreement of the type “We hereby conclude a contract”, without anything more, would not be a contract because it would not have sufficiently precise content. This Article is concerned with the second requirement – the need for sufficient content to the agreement.

The test used here is not, as in some laws, whether the “object” or the price of the contract have been agreed but a broader one of whether the agreement reached is sufficient, or can be fleshed out sufficiently, for the contract to be given effect. It must normally be possible to determine what each party has to do.

B. Terms defined by the parties

The parties may themselves define the terms of the contract with sufficient precision. Under paragraph (1)(a) the test of sufficient precision for this purpose is whether the contract can be given effect. This paragraph will apply where the contract is of a type where the rights and obligations of the parties are not laid down by the law or by applicable usages or practices.

Illustration 1

Two enterprises have entered into negotiations about their “future co-operation in the market”. There will be no contract between them until they have agreed upon the essential features of their co-operation - that is, the main rights and obligations of both parties.

C. Content otherwise determinable

Most contracts belong to certain familiar and usual types (sale of goods, supply of services, employment, insurance, etc.). For these contracts the parties’ agreement on the type of contract (e.g. sale) and a few crucial terms (type of goods and quantity) will suffice. If the parties are silent on other issues (e.g. price, quality, delivery) these issues will be decided either by the general rules in Chapter 9 (Contents and Effects of Contracts) of this Book (e.g. II.–9:104 (Determination of Price), II.–9:108 (Quality)) or by the rules of law applying to that particular type of contract (e.g. for sale contracts IV.A.–2:201 (Delivery)). These issues may also be determined by other means such as usages and practices between the parties.

D. Terms made essential

An agreement to negotiate a contract (a contract to contract) is in itself a binding contract which entails an obligation on both parties to make serious attempts to conclude the planned contract. However the parties are not obliged to reach agreement.

A party may consider a term to be so essential that assent to the contract will be dependent upon agreement on that point. For example, if the parties bargain over the price of the goods to be sold, they show that the price is a decisive term. Even points which are normally not considered essential points can be made so by one party.

However a party who has made one or more points essential for assent to the contract may nevertheless accept performance of the envisaged contract by the other party. In that case the contract is to be considered concluded by the conduct of the parties, and the rules and other factors, see comment C, will supply the disputed terms.

Although two parties have not agreed on all terms they may agree to commence performance. In that event, it will normally be assumed that they did after all intend a contract from that point on. The rules and factors mentioned in comment C may supply the missing terms so as to give sufficient content to the agreement for there to be a contract.

Illustration 2

A has negotiated with B to maintain B's computers every month for one year 'at a monthly fee to be agreed'. Although they have not agreed on A's fee they have decided that A will begin, and A does so. A reasonable fee will be payable, see II.-9:104 (Determination of price).

However, the parties' conduct may demonstrate that they have not concluded a contract:

Illustration 3

The facts are as before but they are still arguing over the fee when A starts work. After one month they realise that they cannot reach agreement and B asks A to stop. B will be liable to A under the rules of unjustified enrichment (Book VII) and will have to reverse the enrichment obtained by the receipt of A's services.

II.-4:104: Merger clause

(1) If a contract document contains an individually negotiated clause stating that the document embodies all the terms of the contract (a merger clause), any prior statements, undertakings or agreements which are not embodied in the document do not form part of the contract.

(2) If the merger clause is not individually negotiated it establishes only a presumption that the parties intended that their prior statements, undertakings or agreements were not to form part of the contract. This rule may not be excluded or restricted.

(3) The parties' prior statements may be used to interpret the contract. This rule may not be excluded or restricted except by an individually negotiated clause.

(4) A party may by statements or conduct be precluded from asserting a merger clause to the extent that the other party has reasonably relied on such statements or conduct.

COMMENTS

A. Merger clauses

When concluding a contract which is embodied in a document the parties sometimes agree that the document contains their entire agreement, and that earlier statements and agreements are not to be considered. Such a merger clause may be useful when during the negotiations the parties made promises and statements based on assumptions which were later abandoned. A merger clause which has been individually negotiated, i.e. inserted in the contract as a result of a mutual discussion between the parties, will prevent a party from invoking prior statements and agreements not embodied in the document. This follows from the principle of freedom of contract.

The merger clause will not apply to prior agreements or statements which, though made when the contract was negotiated, are distinct and separate from the contract.

If, on the other hand, the prior agreement is one which has such a connection with the contract that it would be natural to include it in the contract document, the merger clause will apply.

Illustration

During the negotiations for the sale of a property the parties orally agree that the seller will remove an unsightly ice house from a nearby tract. This agreement was not mentioned in the contract document which contained an individually negotiated merger clause. The buyer cannot require the ice house to be removed.

If, however, the merger clause has not been individually negotiated it will only establish a rebuttable presumption that the parties intended that their prior statements should not form part of the contract, see paragraph (2) of the Article. Experience shows that in such cases a party should be allowed to prove that the merger clause was not intended to cover a particular undertaking by the other party which was made orally or in another document. It often happens that parties use standard form contracts containing a merger clause to which they pay no attention. A rule under which such a clause would always prevent a party from invoking prior statements or undertakings would be too rigid and could often lead to results which were contrary to good faith.

A merger clause will not prevent the parties' prior statements from being used to interpret the contract. This rule in paragraph (3) of the Article applies also to individually negotiated merger clauses, but in an individually negotiated clause the parties may agree otherwise.

On a party's reliance on the other party's later conduct, see Comment B to the following Article.

II.-4:105: Modification in certain form only

(1) A term in a contract requiring any agreement to modify its terms, or to terminate the relationship resulting from it, to be in a certain form establishes only a presumption that any such agreement is not intended to be legally binding unless it is in that form.

(2) A party may by statements or conduct be precluded from asserting such a term to the extent that the other party has reasonably relied on such statements or conduct.

COMMENTS

A. 'No oral modification' clauses in general

Contract terms which provide that modification or termination by agreement must be in writing (or some other specified form) often occur, especially in long-term contracts. Under this Article such clauses will only establish a rebuttable presumption that any such later oral agreements or agreements made by conduct were not intended to be legally binding. It would be contrary to good faith to let the parties' agreement to use a particular form bind them to that form when later they have clearly made up their minds to use another form. If, therefore, it can be shown that both parties agreed to a modification of the contract terms or a termination of the contractual relationship, but did not use the specified form, effect must be given to their agreement. This applies even if in an individually negotiated clause in their contract they provided that they would not give effect to an oral agreement to disregard the "no oral modification" clause.

B. Reliance in spite of a merger or 'no oral modification' clause

If the parties have reached an oral agreement – for example, they have agreed orally to modify a contract that contains a merger clause or a "no oral modification" clause - but it cannot be shown that they have agreed to disapply the clause, yet one party has reasonably acted in reliance on the oral agreement, the other party will be precluded from invoking the clause

Illustration

A construction contract contains a clause providing that "this contract may only be modified in writing signed by both parties". Subsequently the parties orally agree to some changes in favour of the owner. The changed obligations are

performed. When later the contractor invokes another oral modification made in its favour the owner invokes the “no oral modification clause.

The contractor may invoke the performance of the obligations as modified by the first oral agreement to show that the second oral agreement, in favour of the contractor, is binding on the owner. The contractor has in fact relied on the abrogation of the “no oral modification” clause.

Section 2: Offer and acceptance

II.-4:201: Offer

(1) A proposal amounts to an offer if:

- (a) it is intended to result in a contract if the other party accepts it; and*
- (b) it contains sufficiently definite terms to form a contract.*

(2) An offer may be made to one or more specific persons or to the public.

(3) A proposal to supply goods or services at stated prices made by a business in a public advertisement or a catalogue, or by a display of goods, is treated, unless the circumstances indicate otherwise, as an offer to sell or supply at that price until the stock of goods, or the business’s capacity to supply the service, is exhausted.

COMMENTS

A. The “offer and acceptance model”

This section deals with contracts concluded by an offer followed by an acceptance, which is the usual model for the conclusion of contracts.

However, there are other models for the conclusion of a contract. Agreements are often made under circumstances where it is not possible to analyse the process of conclusion into an offer and an acceptance. The rules of this section may sometimes apply to these cases.

B. Requirements for an offer to become effective

An offer is a proposal to make a contract. If it is accepted it becomes a contract provided that the general requirements for concluding a contract are met.

For a proposal to amount to an offer it must (a) show an intention that a contract is to result if it is accepted; and (b) contain terms which are sufficiently definite. Before it can be effective it must also be communicated to one or more specific persons or to the public. This follows from the general rules on the making of juridical acts.

C. Proposals to the public

Proposals which are not made to one or more specific persons (proposals to the public) may take many shapes - advertisements, posters, circulars, window displays, invitations for tenders, auctions etc. These proposals are generally to be treated as offers if they show an intention to be legally bound if they are accepted. However, proposals made in circumstances where the personal qualities of the other party are likely to be important are generally presumed to be invitations to make offers only. This applies to an advertisement of a house for rent at a certain price. Further, an advertisement for a job-opening for persons who meet certain requirements does not oblige the advertiser to employ a person offering his or her services and meeting the requirements. Construction contracts are often made on the basis of public bidding. Owners generally only invite tenders, which are the offers.

Other considerations may also lead to the assumption that, unless otherwise indicated, a proposal is only an invitation to make an offer.

Putting up an item for auction is generally only an invitation to bid. The auctioneer need not accept a bid and may withdraw the goods if the highest bid is too low. The bid is the offer which is accepted by the fall of the hammer. A clear indication that the goods are sold “without reserve” or the like may, however, turn putting them up for auction into an offer.

On the other hand, in order for a proposal to have effect it may be necessary for the proposer to make an offer which may be binding if accepted. This applies for example to an offer of a commission if a representative effects a sale of the proposer’s property. Furthermore, persons who make advertisements etc. may wish prospective suppliers or purchasers to know that they will be able to deliver or acquire the goods or services by accepting the proposal, and that they do not risk refusal of their “acceptance” and the consequent waste of their efforts and reliance costs. Therefore, proposals which are sufficiently definite and which can be accepted by anybody without respect of person are to be treated as offers. This consideration has led to the provision in paragraph (3) and will also result in a proposal being an offer in other cases.

Illustration 1

Company A advertises in a trade paper that it will buy “all fresh eggs delivered to our premises before 22 February” and pay a certain price. A’s advertisement is to be considered an offer which may be accepted by bringing the eggs to its premises.

Illustration 2

In the local paper Bell advertises a plot of land for sale to the first purchaser to tender €25,000 in cash. This constitutes an offer and when Mart tenders €25,000 there is a contract.

D. Goods and services offered at stated prices

Paragraph (3) provides that a proposal to supply goods or services at stated prices made by a business in a public advertisement or a catalogue or by display of goods is regarded, unless the circumstances indicate otherwise, as an offer to sell or supply at that price until the stock of goods, or the business's capacity to supply the service, is exhausted.

The business which advertises goods in the way described is, unless otherwise indicated, taken to have a reasonable stock of goods and a reasonable capacity to provide services.

The rule applies only if the circumstances do not indicate that the proposal is not intended to be an offer. A different intention may appear from the advertisement, etc. and may follow from the circumstances. Thus, if the goods or services are offered on credit terms the business may refuse to deal with persons of poor credit-worthiness.

Although the "offer and acceptance" model is known throughout the laws of the Member States, the precise application of it differs. In particular some laws do not normally recognise an offer by a business to supply goods at a stated price, or a display of goods marked with a price, as an offer. However the rule adopted in paragraph (3) seems preferable, since otherwise a business may mislead customers into thinking that goods or services are available at prices at which the business has no intention to supply them.

II.-4:202: Revocation of offer

(1) An offer may be revoked if the revocation reaches the offeree before the offeree has dispatched an acceptance or, in cases of acceptance by conduct, before the contract has been concluded.

(2) An offer made to the public can be revoked by the same means as were used to make the offer.

(3) However, a revocation of an offer is ineffective if:

(a) the offer indicates that it is irrevocable;

(b) the offer states a fixed time for its acceptance; or

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

COMMENTS

A. Revocation and withdrawal distinguished

An offer becomes effective when it reaches the offeree. However, before it reaches the offeree the offer may be countermanded or withdrawn, and it will not become effective. It cannot then be accepted by the offeree. However, an offer may be revoked before the offeree has dispatched an acceptance; the offer which is revoked has become effective, and might have been accepted, but if the acceptance has not been dispatched, and if the

contract has not been concluded by an act of performance or other act by the offeree, the offer is revoked when the revocation reaches the offeree.

B. Acceptance by conduct

In case of acceptance by conduct the contract is normally concluded when the offeror learns of it. In this case the revocation is effective if it reaches the offeree before the offeror has learned of the conduct. In those cases where the offeree can accept by performing an act without notice to the offeror, the revocation must reach the offeree before the latter begins to perform.

C. Offers to the public

Revocation of offers to the public which are not irrevocable can be made by the same means as the offer. The revocation must then be as conspicuous as the offer. If the offer appeared as an advertisement in a newspaper the revocation must appear at least as visibly in the paper as the advertisement.

The revocation of an offer made in an advertisement which was mailed to the offeree must reach the offeree before the acceptance is dispatched. If the offer has been published in a newspaper, the paper announcing the revocation must be in the offeree's mailbox or available in the news-stands before the offeree dispatches the acceptance.

D. Irrevocable offer

Under paragraph (3) there are three exceptions to the general rule in paragraph (1):

- (a) if the offer indicates that it is irrevocable;
- (b) if it states a fixed time for its acceptance;
- (c) if the offeree had reason to rely on the offer as being irrevocable, and has acted in reliance on the offer.

In these cases the offer, if accepted, results in a contract even though it was purportedly revoked before it was accepted. If the offeror does not perform the obligations under the contract, the normal consequences of such non-performance will follow. The offeror may, for example, have to pay damages.

There is wide variation among the laws of the Member States as to when an offer may be revoked and when not, and, if the offer is regarded as irrevocable, as to the effect if nonetheless the offeror purports to revoke it. Paragraph (3) represents an improved version of the compromise adopted by the CISG. Paragraph (3) applies rules that accord with what businesses or consumers without legal knowledge are likely to understand when they receive an offer. If an offer is stated to be irrevocable for a period, the offeree is reasonable in assuming that an acceptance within the time limit will result in a contract. Likewise, if the offer simply contains a time limit the offeree is likely to understand that

it will be held open until the limit expires. It is of course open to the offeror to state that the offer may be withdrawn at any time.

E. Irrevocability stated

The indication that the offer is irrevocable must be clear. It may be made by declaring that the offer is a “firm offer” or by other similar expressions. It may also be inferred from the conduct of the offeror.

F. Fixed time for acceptance

Another way of making the offer irrevocable is to state a fixed time for its acceptance. This statement must also be clear. If the offeror states that the offer “is good until January 1” the offer is irrevocable. The same applies if the offeror states that the offer “lapses on September 1”. If on the other hand the offeror only advises the offeree to accept quickly, the offer will be revocable.

G. Reliance

The third exception to the rule in paragraph (1) concerns cases 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”. Reliance may have been induced by the behaviour of the offeror. It may also be induced by the nature of the offer.

Illustration 1

Contractor A solicits an offer from sub-contractor B to form part of A’s bid on a construction to be assigned within a stated time. B submits its offer and A relies on it when calculating the bid. Before the expiry of the date of award, but after A has made its bid, B revokes its offer. B is bound by its offer until the date of assignment.

H. Incompatible contracts

It may happen that an offeree accepts an offer knowing that it is incompatible with another contract which the offeror has made. A collector accepts the offer of an art dealer to sell a picture knowing that the dealer has already sold the same picture to another collector. A theatre manager accepts the offer of an actor to perform at the theatre knowing that the actor has engaged himself to perform at another theatre for the same period. The offeree may still accept the offer: the contract is not invalid. The offeree is not bound to inquire into the validity or terms of the first contract or the steps which the offeror intends to take in relation to it. For all the offeree knows, the art dealer may be able to buy back the picture from the first customer or the actor may be willing and able to negotiate a release from his obligations under the first contract.

Neither the fact that at the time of the conclusion of the contract the performance of the obligation was impossible, nor the fact that at that time the party was not entitled to dispose of the assets to which the contract relates, will prevent the contract from coming into existence.

II.-4:203: Rejection of offer

When a rejection of an offer reaches the offeror, the offer lapses.

COMMENTS

When a rejection of an offer reaches the offeror, the offer lapses, even if the offer is irrevocable and even if the time for acceptance has not yet run out. The offer can then not be accepted even if the offeree has a change of mind.

The rejection need not be express but may be implied, for instance if the offeree makes a counter-offer or invites a lower bid or a smaller consignment than the one offered.

An acceptance which contains a modification of the offer may be, but is not always, a rejection. This is regulated by II.-4:208 (Modified acceptance).

A rejection may be withdrawn provided that the withdrawal - whether accompanied by an acceptance or not - reaches the offeror before or at the same time as the rejection. This follows from the general rules on notices.

An offer will normally also lapse if, when the time for acceptance runs out, the offer has not been accepted.

II.-4:204: Acceptance

(1) Any form of statement or conduct by the offeree is an acceptance if it indicates assent to the offer.

(2) Silence or inactivity does not in itself amount to acceptance.

COMMENTS

A. Acceptance

Like other declarations of intention a party's acceptance of an offer can be made by a statement and by conduct, e.g. by performing an act. The acceptance need not be made by the same means as the offer. An offer sent by letter may be accepted by fax or even orally by telephone.

It will be remembered that the intention of a party to enter into a binding legal relationship is to be determined from the party's statements or conduct as they could reasonably be expected to be understood by the other party.

The acceptance must be unconditional. It may not be made subject to final approval by the offeree, or the offeree's board of directors, or by a third party, unless the offeror knew or could reasonably be expected to know that the approval of a third party (e.g. government authorities) was required. II.-4:208 (Modified acceptance) deals with the question of acceptances which contain modifications. In some cases they may be effective acceptances.

B. Silence or inactivity

Silence and inactivity will generally not amount to acceptance. This is provided by paragraph (2). There are, however, some exceptions to this rule under later Articles.

Nor is acceptance required when it follows from an earlier statement by the offeree, e.g. in an invitation to make an offer, or from usage or practices between the parties, that silence will bind the offeree.

Illustration 1

O asks P for a bid to paint the railing surrounding O's factory telling P that it can start painting a week after it has sent its bid unless before that time O has rejected the offer. Having sent the bid and heard nothing from O, P starts painting. O is bound by the contract.

Further, it may follow from a framework agreement between the parties that a party's silence to an offer by the other party will amount to acceptance.

Under the usages of some trades, an order to provide goods or services from one professional to the other will be considered as accepted unless it is rejected by the offeree without undue delay. It may also follow from practices between the parties that silence will be considered as acceptance.

Illustration 2

Between A who runs a maintenance service and B who owns a factory, a practice has developed according to which A sends B a note telling B the day A intends to service B's machinery. If B does not want A's services, B informs A immediately. If B keeps silent, A will come. A's note will oblige A to come at the date fixed. B is obliged to receive A if B does not cancel A's visit immediately upon receipt of the note.

II.-4:205: Time of conclusion of the contract

(1) If an acceptance has been dispatched by the offeree the contract is concluded when the acceptance reaches the offeror.

(2) In the case of acceptance by conduct, the contract is concluded when notice of the conduct reaches the offeror.

(3) If by virtue of the offer, of practices which the parties have established between themselves, or of a usage, the offeree may accept the offer by doing an act without notice to the offeror, the contract is concluded when the offeree begins to do the act.

COMMENTS

A. Significance of the time of conclusion

From the moment when the contract is concluded each party is bound to the other and cannot revoke or withdraw consent. The time of conclusion may also have effects in other respects. For example, standard terms may not be binding if not brought to the attention of the other party until after the conclusion of the contract. And the amount of damages payable for non-performance of a contractual obligation may depend on what was foreseeable at the time of conclusion of the contract.

B. Moment of acceptance

This Article deals with the moment when the acceptance becomes effective and the offer cannot any longer be revoked or withdrawn. The next Article deals with the period of time available for an acceptance to be effectively made.

The general rule is that once the acceptance has been dispatched the offeror can no longer revoke the offer. However, the acceptance becomes binding on the offeree when it reaches the offeror. The offeree cannot then revoke the acceptance, and the contract is concluded.

This rule reflects what seems to be the practical outcome in almost all the laws, though some explain it differently, treating the contract as made when a postal or similar acceptance is dispatched but then applying exceptions which result in much the same outcome as the rule stated in paragraph (1).

C. Conduct

In the case of acceptance by conduct the contract is concluded when the offeror learns of the accepting conduct. An offeree may accept by delivering goods ordered by the offeror, by accepting unsolicited goods sent by the offeror, by opening a credit in the offeror's favour, by starting a production of goods ordered etc. Whether conduct amounts to acceptance will depend upon the circumstances.

Illustration 1

Having learned from a colleague that B may be interested in buying and reselling A's goods, A sends unsolicited goods to B. B accepts by advertising the goods for sale in a trade paper which A reads. A learns of the acceptance on reading the advertisement.

In the case of a more complicated offer, especially if it is one for a contract of long duration, conduct which shows a positive attitude to the offer may not amount to an acceptance of the offer.

Illustration 2

Having learned from a colleague that B may be interested in selling A's goods, A sends B goods with a draft distribution contract by which B is to become A's sole distributor in B's country. B's advertisement of the goods in a trade paper, which A reads, without mention of any distributorship agreement does not amount to an acceptance of the latter.

If, however, the relationship develops, and both parties observe the terms of the draft contract, B's behaviour will be considered an acceptance of the offer though B never signs the draft contract.

When notice of conduct, such as the production of goods ordered or other preparations by the offeree, will not reach the offeror within the time set for acceptance, an express assent by the offeree will be needed. Commencement of performance will be at the offeree's own risk.

Illustration 3

Opera Manager M offers soprano S the part of Susanna in The Marriage of Figaro, which will start in two months time. S immediately starts rehearsing the part, but does not send M any answer. M engages another soprano. S claims to be entitled to play the part. M is not bound by any contract to S.

D. Acceptance without notice

However, if it follows from the offer or from practices between the parties or from usage that the offeree may indicate assent by performing an act without notice to the offeror, the acceptance is effective at the moment performance of the act begins, see paragraph (3). In these cases the start of production or other preparations makes the acceptance effective even though the offeror does not get notice of these acts.

Illustration 4

The facts are the same as in Illustration 3 except that M in his offer to S advises her to start rehearsing at once and by herself, because the rest of the company will tour the province during the next two weeks and cannot be reached. S immediately starts rehearsing. M and S have concluded a contract when S starts rehearsing.

A similar acceptance which is effective from the moment a performance begins may also follow from practice between the parties.

In cases covered by paragraph (3) the acceptance is effective when the act is performed even if the offeror learns of it after the time for acceptance.

The performance which will bind both parties under paragraph (3) is one which the offeree cannot revoke. It only applies to acts which are real performances, not to acts which prepare for a performance. If in view of the offer the offeree applies to a bank for a cash credit in order to increase available funds this act in itself will not constitute a beginning of a performance covered by paragraph (3).

II.-4:206: Time limit for acceptance

(1) An acceptance of an offer is effective only if it reaches the offeror within the time fixed by the offeror.

(2) If no time has been fixed by the offeror the acceptance is effective only if it reaches the offeror within a reasonable time.

(3) Where an offer may be accepted by performing an act without notice to the offeror, the acceptance is effective only if the act is performed within the time for acceptance fixed by the offeror or, if no such time is fixed, within a reasonable time.

COMMENTS

A. Time for acceptance

This Article provides for the period of time within which the offeree's acceptance must reach the offeror in order to be effective.

B. Time fixed

The acceptance of the offer must reach the offeror within the time fixed by the offeror. The acceptance may be made by an express statement or by conduct. This rule represents the practical result reached in most laws under which the question has been considered.

C. Reasonable time

If the time for performance has not been fixed by the offeror, the offeree's acceptance must reach the offeror within a reasonable time. Due account has to be taken of the circumstances of the transaction. One factor is the rapidity of the means of communication used by the offeror.

Another factor is the type of contract. Offers relating to the trade of commodities or other items sold in a fluctuating market will have to be accepted within a short time. Offers relating to the construction of a building may need a longer time for reflection.

In the cases covered by paragraphs (1) and (2), the acceptance must reach the offeror in time. The offeree will generally be expected to use the same means of communication as

the offeror. However, the time for acceptance is to be counted as an entirety. An offeree who receives an offer by mail may, if too much time has been taken for reflection, catch up by accepting by some faster means of communication.

This result does not obtain under the laws of all the Member States; some place the risk of delay in transmission wholly on the offeree. The rule in paragraph (2) is thought to represent a fair compromise between the interests of the parties, neither of whom is to blame for the delay.

D. Acceptance by performance

In the case of acceptance by conduct, notice of the conduct must normally reach the offeror within the time for acceptance. In those situations where an act of performance by the offeree will constitute acceptance even before the offeror gets notice of it, the performance must be commenced within the time fixed by the offeror or, if no such time is fixed, within a reasonable time, but it is not required that the offeror learns of it before that time.

II.-4:207: Late acceptance

(1) A late acceptance is nonetheless effective as an acceptance if without undue delay the offeror informs the offeree that it is treated as an effective acceptance.

(2) If a letter or other communication containing a late acceptance shows that it has been dispatched 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 the offer is considered to have lapsed.

COMMENTS

A. Late acceptance ineffective

The normal rule is that in order for an acceptance to be effective it must reach the offeror within the time for acceptance. Any acceptance which reaches the offeror after that time may be disregarded by the offeror. Normally the offeror does not even have to reject the acceptance.

B. Assent to a late acceptance

Paragraph (1) of the present Article states, however, that notwithstanding that normal rule the offeror may render the late acceptance effective by accepting it. The offeror must then without undue delay inform the offeree. If this is done the contract becomes effective from the moment the late acceptance reached the offeror, and the offeree is then bound by the acceptance.

The notice need not be an express statement of acceptance. An electronic transfer of the purchase money, which will reach the offeree as quickly as a notice, may suffice to make the contract effective.

Illustration 1

A has indicated 31 July as the last day for an acceptance of its offer. B's acceptance reaches A on 2 August. A immediately orders a transfer of the purchase money demanded by B. Notwithstanding that the payment does not come to B's notice until 4 August the contract is concluded on 2 August. Even if B now regrets the acceptance B cannot invoke its lateness to avoid the contract.

C. Late acceptance caused by delay in transmission

If the acceptance is late because the offeree did not send it in time, it is ineffective unless the offeror immediately indicates assent to the contract. If, however, the offeree has sent the acceptance in time, but the acceptance reaches the offeror after the time set for acceptance because of a delay in transmission, the offeree should be notified if the offeror does not want to assent to the contract. The late acceptance should be considered effective unless the offeror without undue delay informs the offeree that the offer as considered to have lapsed or gives notice to that effect. The offeror, however, only has this duty if the acceptance shows that it was sent in time and that it arrived late due to an unexpected delay in transmission.

Illustration 2

A has indicated 31 July as the last day for an acceptance of its offer. B, knowing that the normal time of transmission of letters is two days, sends its letter of acceptance on 25 July. Owing to a sudden strike of the postal service in A's country the letter, which shows the date 25 July on the envelope, arrives on August 2. B's acceptance is effective unless A objects without undue delay.

D. Late acceptance as a new offer

Some legal systems treat a late acceptance as a new offer which the offeror may accept within the time set for acceptance which is often longer than the time provided for in paragraph (1). The Article does not contain such a rule.

II.-4:208: Modified acceptance

(1) A reply by the offeree which states or implies additional or different terms which materially alter the terms of the offer is a rejection and a new offer.

(2) A reply which gives a definite assent to an offer operates as an acceptance even if it states or implies additional or different terms, provided these do not materially alter the terms of the offer. The additional or different terms then become part of the contract.

(3) However, such a reply is treated as a rejection of the offer if:

(a) the offer expressly limits acceptance to the terms of the offer;

*(b) the offeror objects to the additional or different terms without undue delay; or
(c) the offeree makes the acceptance conditional upon the offeror's assent to the additional or different terms, and the assent does not reach the offeree within a reasonable time.*

COMMENTS

A. The main principles

This Article contains the following rules:

- (1) A contract is concluded if the reply expresses a definite assent to the offer.
- (2) A reply containing terms which materially alter the terms of the offer is a rejection and a new offer.
- (3) Additional and different terms which do not materially alter the terms of the offer become part of the contract.
- (4) If in the case mentioned in (3) the offeror has limited the acceptance to the terms of the offer, or objects without undue delay to the different or additional terms, the offer is considered to have been rejected by the different or additional terms. The same applies if the offeree makes acceptance conditional upon the offeror's assent to the additional or different terms, and the offeror does not give assent within a reasonable time.

B. Considerations underlying the main principles

The notion that non-material additions or modifications become part of the contract has been widely accepted. Such additions and modifications are frequently attempts to clarify and interpret the contract, or to supply terms which would otherwise be considered "omitted terms". The offeror should object to them if they are not acceptable.

Under these rules an answer containing additions or modifications which materially alter the terms of the contract is to be considered as a counter-offer which the offeror may accept either by express assent or by conduct, for instance by performance of the contract. The special question of the "battle of forms" (conflicting standard terms) is covered in the following Article.

C. When is an alteration material?

Whether an alteration is material is a question of degree to be decided on the facts of each case. An alteration would not be material if it would not be likely to influence the offeror in deciding whether to contract or as to the terms on which to contract.

CISG art. 19(3), provides a list of additional and different terms which are to be considered material, such as terms relating, among other things, to the price, payment, quality and quantity of the goods, place and time of delivery, extent of one party's liability to the other, or the settlement of disputes. This technique has not been used in the

present Article. The range of contracts and circumstances covered by the model rules is so extensive that any such list could only have been illustrative. For example, though a clause relating to settlement of disputes is often material, if among merchants in the trade it is usual, though not customary, to refer disputes to settlement by arbitration, an arbitration clause in the offeree's answer will not materially alter the terms of the contract.

D. Modification by conduct

An acceptance by conduct may contain additional or different terms. These terms may be material, for instance, if the offeree dispatches a much smaller quantity of a commodity than that which was ordered by the offeror, or immaterial if only a very small quantity is missing.

E. Acceptance of modification by conduct

A modification is an "acceptance" which makes the answer a rejection and a new offer. It may be accepted by the offeror's conduct. After having received the modified acceptance the offeror may perform the contract or accept the offeree's performance and this will amount to an acceptance of the new offer.

Illustration

S offers B a contract under which B is to buy 350 tonnes of coal, at a certain price, to be delivered in instalments. The draft contract document contains a jurisdiction clause. B returns the contract document with the jurisdiction clause struck out and an arbitration clause inserted instead. The contract is then put into S's manager's desk by one of S's employees. S subsequently delivers the first instalment which B accepts. Before the second instalment is to be delivered there is a sharp rise in the market price of coal, and S then tries to avoid the contract by invoking B's modified acceptance to which, it says, it never has agreed. However, S is to be considered as having accepted the contract by delivery of the first instalment.

F. Modified acceptance and conflicting standard terms

A reference in a typed or hand-written reply to the offeree's standard terms which contain terms which materially alter the terms of the contract is covered by the present Article when the offeror has not made any reference to standard terms. If the offeror has referred to standard terms, the case is covered by the following Article on conflicting standard terms (the battle of the forms) even though the reference is made in a hand-written or typed letter.

II.-4:209: Conflicting standard terms

(1) If the parties have reached agreement except that the offer and acceptance refer to conflicting standard terms, a contract is nonetheless formed. The standard terms form part of the contract to the extent that they are common in substance.

(2) However, no contract is formed if one party:

(a) has indicated in advance, explicitly, and not by way of standard terms, an intention not to be bound by a contract on the basis of paragraph (1); or
(b) without undue delay, informs the other party of such an intention.

COMMENTS

A. The battle of forms

To-day's standardised production of goods and services has been accompanied by the standardised conclusion of contracts through the use of pre-printed supply and purchase orders. The pre-printed forms have blank spaces meant for the description of the performance, the quantity, price and time of delivery. All other terms are printed in advance. Each party tends to use terms which are favourable to it. Those prepared by the supplier, or by a trade organization representing suppliers, may, for example, contain limitations of liability in case of difficulties in production and supply or of defective performance, and provide that customers must give notice of any claim within short time limits. The forms prepared by the customer or its trade association, in contrast, hold the supplier liable for these contingencies, and give the customer ample time for complaints.

A special rule for this battle of forms is called for because it often happens that the parties purport to conclude the contract each using its own form although the two forms contain conflicting provisions. There is an element of inconsistency in the parties' behaviour. By referring to their own standard terms, neither wishes to accept the standard terms of the other party, yet both wish to have a contract. A party will only be tempted to deny the existence of the contract if the contract later proves to be disadvantageous for that party. The purpose of the rule is to uphold the contract and to provide an appropriate solution to the battle of forms.

Compared to the rules applied by those laws which still require offer and acceptance to be "mirror images" of each other before there can be a contract, this Article provides solutions which are much more likely to accord with the reasonable expectations of businesses and consumers who are not familiar with the technicalities of contract law. It does not, however, limit the freedom of the parties in any way. They remain free to state exactly what will or will not amount to offer and acceptance in their dealings.

B. Scope of the rule

The rule in the Article is not needed in every situation in which each party has a set of standard terms and these are not identical.

First, the parties may have so conducted themselves that only one set applies. This may happen because they have agreed explicitly that one set should govern their contract, for example when a party has signed a document which is to be treated as the contract, although in previous correspondence that party has referred to its terms of contract. It may also happen because one party fails to bring its standard terms to the other party's attention before or when the contract is concluded.

Secondly, the question as to which terms govern only arises when the standard terms are in real conflict. This is not always the case. It may be that one party's standard terms contain terms which are implied in any contract of that kind, or that they merely list technical specifications of the goods or services to be supplied or performed. Such clauses are often not at variance with the other party's standard terms, which may not contain any clauses on these points.

There is, however, a battle of forms even if only one party's terms contain provisions on an issue, when its terms deviate from the general rules of law, and it is to be understood that the other party meant the rules of law to cover the issue. Thus the rules in the Article will govern the situation where in its offer the supplier's general terms contain a price escalation clause and the buyer in its acceptance uses a form which says nothing about later changes in the price.

C. The solutions

Is there a contract? The Article provides that there may be a contract even though the standard terms exchanged by the parties are in conflict. This is an exception to the general rule on modified acceptance in the preceding Article. Under that Article, an acceptance which differs from the offer will be effective only if the differences are not material. Otherwise, the acceptance would be (i) a rejection of the offer and (ii) a new offer. It is true that, if the party who receives the new offer does not object to it and performs the contract, it will be deemed to have accepted that there is a contract. The difference made by the present Article, is that the contract may be formed by the exchange of standard terms, rather than only if and when the performance takes place.

Under the present Article, a party who does not wish to be bound by the contract may indicate so either in advance, or later.

If done in advance, this must be indicated explicitly and not by way of standard terms. Experience has shown that a party whose standard terms provide that there will be no contract unless those terms prevail (such a clause is often called a 'clause paramount') often remains silent in response to the other party's conflicting terms, and acts as if a contract had come into existence. The provision is often contradicted by the party's own behaviour. To uphold it would erode the rule.

A party, however, may prevent a contract from coming into existence by informing the other party, without undue delay after the exchange of the documents which purport to conclude the contract, of an intention not to conclude a contract.

Which terms govern? If despite a conflict between the two sets of terms, a contract does come into existence, the question is: which terms will apply? Until recently many legal systems would answer the question as follows: By performing without raising objections to the new offer, the recipient must be considered to have accepted the standard terms

contained in the new offer (the ‘last shot’ theory). Under another theory it is argued that a party which states that it accepts the offer should not be allowed to change its terms. Under this theory (the so-called ‘first shot’ theory) the conditions of the first offeror prevail.

Under the present Article the standard terms form part of the contract only to the extent that they are common in substance. The conflicting terms ‘knock out’ each other. As neither party wishes to accept the standard terms of the other party, neither set of standard terms should prevail over the other. To let the party which fired the first or the last shot win the battle would make the outcome depend upon a factor which is often coincidental.

It is then for the court to fill the gap left by the terms which knock each other out. The court may apply applicable rules of law to decide the issue on which the terms are in conflict. Usages in the relevant trade and practices between the parties may be particularly important here, for example if there is a usage of employing terms which have been made under the auspices of official bodies or standard forms promoted by some other neutral organisation. If the issue is not explicitly covered either by the law or by usages or practices, the court or the arbitrator may consider the nature and purpose of the contract and apply the standards of good faith and fair dealing to fill the gap.

Illustration 1

A orders some goods from B. A’s order form says that the seller must accept responsibility for delays in delivery even if these were caused by force majeure. The seller’s sales form not only excludes the seller’s liability for damages caused by late delivery where there was force majeure, but also states that the buyer has no right to terminate for delay unless the delay is over six months. The delivery is delayed by force majeure for a period of three months and the buyer, who because of the delay no longer has any use for the goods, wishes to terminate the contractual relationship. The two clauses knock each other out and the general rules of law will apply: thus the seller is not liable in damages but the buyer may terminate for delay if the delay was fundamental.

The term “common in substance” conveys that it is identity in result not in formulation that counts. However, what is “common in substance” will not always be easy to decide.

Illustration 2

A sends B an order, which has on the back general terms providing, among other things, that any dispute between the parties will be submitted to arbitration in London. B sends A an acknowledgement accepting the offer. On the back of the acknowledgement is a clause submitting all disputes to arbitration in Stockholm. Although offer and acceptance have in common that they both refer to arbitration, the clauses are not ‘common in substance’ and accordingly neither of the places of arbitration is agreed upon. But did the parties agree on arbitration?

A court might conclude that the parties preferred arbitration to litigation in any case and would then apply the normal rules on jurisdiction in civil and commercial matters to decide where the place of arbitration should be.

If, however, the court finds that the parties or one of them would only have agreed to arbitration if it was to be held at a certain place the arbitration clause may be disregarded and the court may then admit the action.

II.-4:210: Formal confirmation of contract between businesses

If businesses have concluded a contract but have not embodied it in a final document, and one without undue delay sends the other a notice in textual form on a durable medium which purports to be a confirmation of the contract but which contains additional or different terms, such terms become part of the contract unless:

- (a) the terms materially alter the terms of the contract; or*
- (b) the addressee objects to them without undue delay.*

COMMENTS

A. Background

Between persons engaged in business transactions who have made a contract, it may not be entirely clear on what terms their contract has been concluded. A party may then send the other party a written confirmation containing the terms which the first party believes were agreed upon, and the terms which that party believes to be implied. The party needs to send this confirmation in order to be sure of the terms of the contract before performance begins. In most cases the recipient will assent to the written confirmation by silence, having no reason to reconfirm what has already been agreed upon and confirmed by the other party. The silence will, therefore, be considered as assent. A recipient who disagrees with the terms must object without undue delay.

In many cases the additional terms provided in the confirmation will take the shape of an interpretation of the contract.

Illustration 1

Upon the termination of a distribution contract between the supplier S and the distributor D, D requests, and it is agreed orally, that S will take over D's stock of machinery "at the usual trade discount". These words usually mean the discount applied in sales from S to D (30%). However, in a letter of confirmation sent to S immediately after the oral agreement D points out that it means the discount which D applies to customers (28%). Since S does not object to D's letter, D's interpretation will prevail.

The rule stated in this Article is not recognised, or not clearly recognised, in all the laws but it again represents what seems to be widely accepted as fair commercial dealing between businesses. It would not be appropriate to apply it between a business and a consumer; however, as consumers cannot be expected to check all the documents sent to them by the business to ensure that they are consistent with the oral agreement made earlier.

B. Requirements

In order for the confirmation to become binding upon the recipient, the following requirements must be met:

- (1) The rule only operates between persons operating in their business capacity, as distinguished from relationships between professionals and consumers or between private individuals.
- (2) The confirmation must be in writing.
- (3) The contract must have been incomplete in the sense that it did not materialise into a document which was a record of all the contract terms.
- (4) The confirmation must reach the recipient without undue delay after the negotiations and it must refer to them.
- (5) If the recipient does not object without undue delay to the terms additional to or different from the terms agreed upon in the preceding negotiations, they become part of the contract unless they materially alter the terms agreed upon.

Illustration 2

Upon the oral conclusion of a sales contract S sends B a letter of confirmation in which, inter alia, it is provided that B has to make an advance payment of half of the purchase price three months before delivery of the goods. S cannot prove that this was agreed when the contract was concluded; the clause is unusual in the trade, and would materially alter the terms of the contract. B is not bound by the clause on prepayment. S, on the other hand, must perform the contract without getting the advance payment.

II.-4:211: Contracts not concluded through offer and acceptance

The rules in this Section apply with appropriate adaptations even though the process of conclusion of a contract cannot be analysed into offer and acceptance.

COMMENTS

A. Other models than the offer and acceptance model

The conclusion of a contract may not always be separated into an offer and an acceptance. The parties may start with a letter of intent or a draft agreement made by one party or a third party. Then follow negotiations either in each other's presence or in an exchange of letters. Or they start by sitting down together to negotiate, sometimes with rather vague ideas of where they will end. It may not be easy to tell where in this process the parties reach an agreement which amounts to a binding contract. The same may be true of the many contracts that are made by conduct alone, as when a motorist parks in a car park and gets a ticket from a machine or a traveller takes out travel insurance by putting money into a slot machine and receiving the policy from the machine. Or a multilateral contract may be concluded by the parties voting at a meeting to accept the terms of a prepared draft.

B. Application of Section 2

The rules in Section 2 cannot always be applied to such other models. Sometimes, however, they may apply:

Illustration 1

Two parties meet to draft a written contract. When they have made the draft they agree that each party will have two weeks to decide whether to accept it. The draft is treated as an "offer". If after the two weeks each of them has not received the other party's acceptance there is no contract. The same applies if before that time a party receives the other's rejection. If during the respite a party makes proposals for additions which materially alter the terms of the draft, this is to be treated as a rejection and a "new offer".

Illustration 2

After conclusion of an oral agreement a person acting for two professional parties is asked to prepare a written contract. The person then sends both parties a draft accompanied by a letter saying that the draft will be taken to be their agreement unless either replies to the contrary within a certain time. The draft contains the terms which the parties had agreed upon and some additional terms which reflect usual commercial practices in the trade. The parties will be bound if neither opts out within the stated time.

Section 3: Other juridical acts

II.-4:301: Requirements for a unilateral juridical act

The requirements for a unilateral juridical act are:

- (a) that the party doing the act intends to be legally bound or to achieve the relevant legal effect;*
(b) that the act is sufficiently certain; and
(c) that notice of the act reaches the person to whom it is addressed or, if the act is addressed to the public, the act is made public by advertisement, public notice or otherwise.

COMMENTS

A. General

The rules on the formation of contracts, with their emphasis on agreement, cannot be applied directly to the formation of other unilateral acts. Nonetheless, questions about the effectiveness of a unilateral juridical act can arise.

Illustration 1

Under a contract between A and B, A has the right to terminate the contractual relationship upon one month's notice and the payment of a certain sum. A sends B a letter giving one month's notice but then changes her mind and calls B to tell her to ignore the notice, which has not yet reached B. As the notice has not yet taken effect it can be revoked. The intention necessary under sub-paragraph (a) is no longer present (see also II.-1:106 (Notice) paragraph (5)).

This Article represents the general approach taken by the majority of laws in which the matter has been discussed.

An offer and an acceptance are types of unilateral juridical acts but the more specific rules regulating them will prevail over the general rules in this Article in any case of conflict (see I.-1:102 (Interpretation and development) paragraph (5)).

B. Requirements

The requirements for the formation of a unilateral juridical act are, however, very similar to the requirements for the formation of a contract. The need for an intention on the part of the maker of the act to be legally bound or to achieve the desired legal result, and the need for sufficient certainty are very similar to the requirements for a contract. These requirements are coupled with the need for an appropriate externalisation of the intention. A secret intention which is not communicated to anyone is not binding. The person who forms an intention to achieve some legal result remains free to have a change of mind so long as the intention, even if written down, is not communicated to anyone. The general rule is that a juridical act is made only when notice of it reaches the person to whom it is addressed. The general provisions on notices determine when a notice "reaches" the addressee. A special rule is needed for juridical acts addressed to the public at large and here the Article requires that the act be made public by advertisement, public notice or otherwise. The model rules are not intended to apply to testamentary acts. If they did so apply then the requirement of notice would have to be modified: the event which

precludes a subsequent change of mind is not notice in such a case but death. There are also specific rules which dispense with the need for a juridical act to reach the addressee. For example, an acceptance by doing an act may in certain circumstances be effective even without communication to the offeror. See II.-4:205 (Time of conclusion of the contract) paragraph (3).

II.-4:302: How intention is determined

The intention of a party to be legally bound or to achieve the relevant legal effect is to be determined from the party's statements or conduct as they were reasonably understood by the person to whom the act is addressed.

COMMENTS

This is very similar to the equivalent rule for contracts.

II.-4:303: Right or benefit may be rejected

Where a unilateral juridical act confers a right or benefit on the person to whom it is addressed, that person may reject it by notice to the maker of the act, provided that is done without undue delay and before the right or benefit has been expressly or impliedly accepted. On such rejection, the right or benefit is treated as never having accrued.

COMMENTS

A. Freedom to reject right or benefit

This Article reflects the policy that a person should not be forced to accept a right or benefit which the person does not want. There could be various reasons for rejecting an apparent benefit. The recipient may have personal reasons for not wishing to be under any moral obligation to the person trying to confer the benefit. Or the benefit may come with inherent burdens or disadvantages. For example, the owner of certain types of property may well come under certain duties or burdens of a public law nature.

It is obvious that the Article cannot apply to all juridical acts. A person who is given notice of avoidance of a contract, for example, cannot reject it. It should also be remembered that this is just a default rule. The parties may have contracted otherwise. The recipient may be contractually bound to accept the right or benefit.

CHAPTER 5: RIGHT OF WITHDRAWAL

Section 1: Exercise and effect

II.–5:101: Scope and mandatory nature

(1) The provisions in this Section apply where under any rule in Section 2 or Book IV a party has a right to withdraw from a contract within a certain period.

(2) The parties may not, to the detriment of the entitled party, exclude the application of the rules in this Chapter or derogate from or vary their effects.

COMMENTS

A. General rules on exercise and effect of withdrawal

Section 1 of this Chapter contains a set of rules which are applicable to all individual rights of withdrawal. These common rules concern only the exercise and effect of the right of withdrawal, including some related matters such as time limits for exercising this right and requirements to inform the party who is entitled to withdraw on the basis of this right. Paragraph (1) clarifies that these rules apply where a party has the right of withdrawal under any rule in Section 2 of this Chapter or of Book IV. Such withdrawal rights are granted in II.–5:201 (Contracts negotiated away from business premises) and II.–5:202 (Timeshare contracts) and may be granted in possible future parts of Book IV. The present Article provides that the rules of this Section apply, where under these rules in the DCFR the right of withdrawal exists, but they do not indicate *when* the right of withdrawal exists. Hence, this Article does not extend the rights of withdrawal beyond those that are established by other provisions. The general rules on exercise and effect of withdrawal of this Section are modelled on the individual provisions on withdrawal rights in Community law, namely in the Doorstep Selling Directive 1985/577/EEC, the Distance Selling Directive 1997/7/EC, the Financial Services Distance Selling Directive 2002/65/EC, the Timeshare Directive 1994/47/EC and the Life Assurance Directive 2002/83.

B. Mainly, but not exclusively consumer law

The provisions in this Section are drafted as rules of general contract law, applicable to all parties to contracts including businesses, although their main field of application consists of consumer contracts. The reason is that in systematic terms, the concept of the right to withdraw from a contract (or, as the case may be, from a binding offer) does not necessarily have to be restricted to the field of consumer protection. Although the right to withdrawal did emerge in this sector, its purpose may transcend the concept of consumer, as protection for one party from being too hastily bound in a situation where that party is in a structurally disadvantageous position at the time of conclusion of the contract. Correspondingly, in Art. 35(1) of the Life Assurance Directive 2002/83/EC the right of withdrawal is available irrespective of whether the entitled party is a consumer. Thus,

existing EC law (and many national laws) do not totally restrict the right of withdrawal to consumer contracts, neither in its legal structure nor in all individual provisions. The (potentially) overarching nature of the rules for rights of withdrawal implies that they are more accurately categorised as general contract law than as belonging only to the specific field of consumer protection law. A right of withdrawal may be granted under any piece of legislation, if the legislator assumes that a party, whether a consumer or a business, who concludes particular types of contract, or does so under particular circumstances, deserves particular protection which is best served by the right of withdrawal.

C. Mandatory nature

Because the main purpose of the general rules on withdrawal rights is to protect the entitled party, paragraph (2) stipulates that the rules of this Chapter (Section 1 and Section 2) may not be amended to the disadvantage of the protected party by any agreement between the parties. For the same reason, the present Article does not prohibit any contractual amendments which are more favourable to the protected party. Therefore, the parties to the contract are allowed to facilitate the exercise of the withdrawal and to extend its effects by deviating from the rules of this Chapter, as long as this operates in favour of the entitled party. Parties may equally agree that a party to the contract may withdraw even where no such right is granted in these model rules.

Although the rules of this Section apply expressly only where a party has a right of withdrawal granted by these model rules, this does not exclude the application of this Section to contractually stipulated rights of withdrawal. In those cases, the rules in this Section are not mandatory in the sense of paragraph (2). Negotiated rights of withdrawal do not have to be regulated expressly in this Section, as they are not based on explicit provisions of the DCFR, but on agreement between the parties, which in turn is based upon the principle of freedom of contract.

Illustration 1

In a sales contract concluded outside of business premises within the meaning of II.–5:201 (Contracts negotiated away from business premises), the buyer and seller agree that the buyer has three months within which he may exercise the right of withdrawal. This term deviates from II.–5:103 (Withdrawal period) where a fourteen day period is provided. As paragraph (2) of the present Article only prevents agreements to the disadvantage of the entitled party, the term is valid.

Illustration 2

In a sales contract concluded outside of business premises within the meaning of II.–5:201 (Contracts negotiated away from business premises), the buyer and seller agree that the buyer must exercise her right of withdrawal within three days. This term is contrary to II.–5:103 (Withdrawal period). As paragraph (2) of the present Article states that the following provisions are mandatory, this term is invalid.

Illustration 3

As above, but the buyer and the seller agree that the buyer must give reasons why the right of withdrawal is exercised. Again, this agreement is not in accordance with II.–5:102 (Exercise of right to withdraw), and this term is therefore invalid.

D. Meaning and function of withdrawal

The Directives which grant withdrawal rights, and the national laws even more so, use many different terms for regulating withdrawal rights. In order to reach a coherent terminology these model rules have opted for the uniform use of the term “withdrawal”. Its meaning and the main function of withdrawal rights is described in the definition provided in Annex I, which reads:

“A right to ‘withdraw’ from a contract or other juridical act is a right to terminate the legal relationship arising from the contract or other juridical act, without having to give any reason for so doing and without incurring any liability for non-performance of the obligations arising from that contract or juridical act. The right is exercisable only within a limited period (in these rules, normally 14 days) and is designed to give the entitled party (normally a consumer) additional time for reflection. The restitutionary and other effects of exercising the right are determined by the rules regulating it.”

The idea behind such a generalisation is that the individual withdrawal rights to be found in Community law and in the national laws are based upon a common concept. They all require the presence of specific situations of contract formation where in the eyes of the law one party, usually a consumer, deserves protection. In doorstep sales or distance sales (cf. II.–5:201 (Contracts negotiated away from business premises), this need for protection arises from the way in which the contract is initiated. In distance sales, it reflects in particular the customer’s inability to visually inspect the goods before buying, as well as the customer’s lower inhibition threshold to buy goods. In timeshare (cf. II.–5:202 (Timeshare contracts) and life assurance contracts, the complexity of the contract calls for protection of the consumer. In order to counteract the structural imbalance between the parties in such situations, the right of withdrawal allows the protected party to escape contractual obligations without having to give reasons.

E. Differences between withdrawal and termination and other rights to be released from a contract

The rights of withdrawal provided by these rules must be distinguished from other rights to be released from a contract or a binding juridical act. The primary aim of withdrawal rights is to allow the consumer time for further consideration (a so-called ‘cooling-off’ period) and for obtaining information. The entitled party can therefore rely on a right of withdrawal without having to show non-performance by the other party, as would be required for termination of a contractual relationship under Art. 3(2) and (5) of the Consumer Sales Directive. (which uses the word ‘rescind’) or under Art. 49 CISG (which uses the term ‘avoidance’) or under Book III, Chapter 3, Section 5 of these model rules. Nor is withdrawal linked to mistake, fraud or other conduct of which the law disapproves. The applicable principle is rather that withdrawal brings the contractual obligations to an

end without there having to be any specific reasons, as long as the requirements for both the right and its exercise (such as time limits) have been met.

F. Overlapping remedies

There may be situations in which all the requirements for the right of withdrawal are met, but where the contract is void or voidable under Book II Chapter 7, or where the contractual relationship can be terminated for other reasons (e.g. termination under Book III, Chapter 3, Section 5). In this case, the entitled party should not be limited to remedies based on these other reasons, but should rather be entitled to exercise the right of withdrawal and benefit from the effects of withdrawal, which may be more favourable. It would counteract the protective effect of the right of withdrawal if it could be considerably compromised by the mere existence of a further defect of the contract, and even more so if this defect has been caused by the other party (cf. also II.–7:216 (Overlapping remedies) with regard to avoidance and remedies for non-performance).

Illustration 4

Two parties conclude a contract which is avoidable under II.–7:205 (Fraud) because of one party's fraudulent behaviour. The other party may nevertheless withdraw from this contract and is not confined to the remedy of avoidance under Book II Chapter 7.

G. Provisions on withdrawal rights in other parts of these model rules

Some general provisions on withdrawal rights are located in other parts of these model rules. For instance, II.–3:103 (Duty to provide information when concluding contract with a consumer who is at a particular disadvantage) paragraph (1) stipulates that the necessary information on the right of withdrawal must be provided within a reasonable time before the conclusion of the contract. II.–3:107 (Remedies for breach of information duties) paragraph (1) postpones the beginning of the withdrawal period if certain information has not been given to a consumer, but also provides for a maximum time limit of one year for the withdrawal period.

As the rules of this Section generally regulate the exercise and the effects of all rights of withdrawal, in some cases provisions for a particular right of withdrawal deviate from the general rules. This is the case, for instance, in II.–5:202 (Timeshare contracts) paragraphs (2) and (3) with regard to the restitutionary effects of withdrawal. As usual, such particular provisions will take precedence under the general principle of *lex specialis derogat legi generali* (see I.–1:102 (Interpretation and development) paragraph (3)).

II.-5:102: Exercise of right to withdraw

A right to withdraw is exercised by notice to the other party. No reasons need to be given. Returning the subject matter of the contract is considered a notice of withdrawal unless the circumstances indicate otherwise.

COMMENTS

A. Exercise by notice

In stipulating that the right to withdraw is exercised by notice, the provision makes applicable II.-1:106 (Notice) paragraph (3), which lays down that notice becomes effective when it reaches the addressee. Generally, this requirement ensures that the entitled party communicates the withdrawal to the other party who thereby becomes aware of the withdrawal and, if necessary, can prepare the restitution of, e.g., goods delivered and payments made under the contract. According to II.-1:106 (Notice) paragraph (2) the notice may be given by any means appropriate to the circumstances. This includes an explicit declaration of the withdrawal but also, as the 3rd sentence of the present Article clarifies, by returning the subject matter of the contract (cf. B. below).

The communication must be sufficiently precise to indicate that the entitled party is withdrawing from the contract. It is also necessary that the withdrawing party and the contract from which that party is withdrawing can be clearly identified. The entitled party does not have to use the word “withdrawal”. It is sufficient if the addressee can understand from the notice that it is meant as a communication of withdrawal.

B. Returning the subject matter of the contract

"Returning" means sending back the subject matter of the contract (which is, in such a case, usually goods) to the supplier in a way which the entitled party can choose, for example, by handing them over personally, or by sending them by mail. It is also necessary that the withdrawing party can be clearly identified by the addressee. Returning the subject matter of the contract is of course not an option for services. In case it is unclear whether the subject matter of the contract is returned in order to withdraw from the contract or, for instance, to claim replacement because of a defect, sentence 3 of the provision indicates the interpretation of the communication as the exercise of a right to withdraw.

Illustration 1

B is entitled to withdraw from a contract. She simply returns the goods by mail without giving any further information. The goods reach the other party. In this case, the withdrawal is effective.

C. No reasons need to be given

It is one of the core characteristics of a withdrawal right that no reasons have to be given in order to exercise the right effectively. In fact, a reason does not even have to exist. The function of a withdrawal right is to give the entitled party the necessary time to rethink the decision to conclude the contract. A right to withdraw does not require any non-performance of obligations by the other party or any other specific justification. That is why the entitled party does not need to give any reasons when exercising its right to withdraw.

Illustration 2

A is entitled to withdraw from a contract. He sends a letter to the other party which states that he considers himself to be no longer bound to the contract. But he does not give any reasons for the withdrawal. Nevertheless, the withdrawal is effective.

Illustration 3

F has the right of withdrawal from a contract with G. F communicates her withdrawal to G and indicates reasons for her withdrawal which in fact are unfounded. The withdrawal is effective (provided all other requirements have been met) as no reasons have to be given at all. Therefore, unfounded reasons do not affect this right.

D. No formal requirements for the exercise of withdrawal

The provision does not stipulate a formal requirement for the exercise of the right to withdraw. The reference to the provisions on notice makes clear that, according to paragraph (2) of II.-1:106 (Notice), the withdrawal may be communicated by any means appropriate to the circumstances. This is partially in contrast to the relevant Directives which allow the Member States to stipulate formal requirements for the exercise of the right to withdraw. Also the ECJ emphasises that the Member States are not precluded from adopting rules which provide that the communication of withdrawal is subject to formal requirements (for the Doorstep Selling Directive 1985/577/EEC cf. case C-423/97 – *Travel Vac*, para. 51). Some, but not many, Member States have made use of this option by stipulating that the entitled party can only withdraw by notice in textual or written form (or even, in a few cases, by registered letter).

Requirements as to form may indeed provide a higher degree of certainty. This can be in the interest of both parties and could even help the entitled party to prove that the right of withdrawal has been exercised in time. But this requirement may also lead to the result that the entitled party loses the right if the required form is not fulfilled. Moreover, a requirement of textual or written form would not serve as reliable proof for the entitled party. If a formal requirement was to be probative, anything short of a registered letter would not fulfil this function. A further argument against the introduction of a formal requirement is that it could be seen as inconsistent with the possibility of withdrawing by returning the subject matter of the contract. Also the entitled party might find it unlikely,

and therefore might not expect, that a contract concluded without any formality (e.g. over the phone) could not be withdrawn from in the same way.

II.-5:103: Withdrawal period

(1) A right to withdraw may be exercised at any time before the end of the withdrawal period, even if that period has not begun.

(2) Unless provided otherwise, the withdrawal period begins at the latest of the following times;

(a) the time of conclusion of the contract;

(b) the time when the entitled party receives from the other party adequate notification of the right to withdraw; or

(c) if the subject-matter of the contract is the delivery of goods, the time when the goods are received.

(3) The withdrawal period ends fourteen days after it has begun, but no later than one year after the time of conclusion of the contract.

(4) A notice of withdrawal is timely if dispatched before the end of this period.

COMMENTS

A. Function of the withdrawal period

The main function of the withdrawal period is to determine exactly the moment until when the right to withdraw can be exercised. This is important, because the additional period of reflection which is granted to one party to the contract leads to uncertainty for the other party as to whether the contractual relationship will continue to exist and whether restitution will be required in relation to goods or services provided and payments made. Paragraph (1) therefore stipulates that a right to withdraw can only be exercised before the end of the withdrawal period. According to paragraph (4) timely dispatch suffices (cf. E. supra). When the withdrawal period ends, the right to withdraw ceases to exist. It is not the function of the withdrawal period to determine the point in time from which the right to withdraw can be exercised. Paragraph (1) clarifies, that the right to withdraw can be exercised even before the withdrawal period has begun (e.g. after the conclusion of the contract, but before the goods are delivered, cf. paragraph (2)(c) of the present Article).

B. Length of the withdrawal period

The normal period of withdrawal is fourteen days (paragraph (3)), calculated from its beginning as set out in paragraph (2). By stipulating a fourteen day period, this rule mediates the great diversity of withdrawal periods to be found in Community law and in the Member States' laws, which vary between 7 and about 15 days (and in some specific

cases even reach 30 days). Such a unification of the different withdrawal periods is desirable, because this would very much facilitate the conduct of business where withdrawal rights apply. The common idea behind the withdrawal period is to guarantee a sufficient period of time for calm consideration ('cooling off' period) and for obtaining information. The fourteen day period follows the model of the Financial Services Distance Selling Directive 2002/65/EC, which – unlike the earlier Directives which provide shorter periods – seeks full harmonisation. The model of a uniform fourteen day period has also been followed by some Member States, whereas very few Member States have gone beyond the fourteen days by providing (only slightly) longer periods.

The fourteen day period set out in paragraph (3) always applies unless a *lex specialis* provides for a different period because of specific needs of protection (which could be the case, for instance, for life assurance contracts, for which a possible future part in Book IV on insurance contracts could follow the model of the Life Assurance Directive 2002/83/EC, where a 30 day withdrawal period is stipulated). As the fourteen day period begins at the point in time set out in paragraph (2), the actual period during which the entitled party can withdraw can be much longer than fourteen days and amount up to one year. Also the rules on the computation of time, which are set out in Annex 2, can lead to a prolongation of the actual timespan for withdrawal, because, for instance, a time limit which would otherwise end on a Saturday, a Sunday or a national holiday will expire at the end of the next working day instead (cf. paragraph (5) of Annex 2).

C. Beginning of the withdrawal period

Paragraph (2) sets out a flexible beginning of the withdrawal period, by naming three events or actions. The period begins at the time when the latest of these events occurs: (a) the conclusion of the contract; (b) the receipt of adequate notification of the right to withdraw; or (c) the receipt of the goods, if the subject-matter of the contract is the delivery of goods. As the withdrawal period is to be calculated from one of these events or actions, it has to be computed according to the rule given in paragraph (2)(b) of Annex 2.

The time when the contract is concluded has to be determined according to the rules laid down in Chapter 4 of Book II. The principle that the withdrawal period does not commence before the conclusion of the contract is expressly laid down in several provisions of Community law and in many Member States' laws. The reason for this rule is that the entitled party must not lose the right of withdrawal even before the contractual obligations have been conclusively fixed. If the entitled party, for instance, makes a binding offer, it is not known whether the offer will be accepted by the other party. If the fourteen days withdrawal period began when the offer was made, the offeror would have to withdraw the offer within the fourteen days just by way of precaution; and also in cases where it has not yet been accepted and perhaps will never be accepted. This would be a very formalistic result, which may surprise the offeror because it forces him or her to make an unnecessary declaration. The rules should avoid such provisions which lead to inefficiency. For this reason, paragraph (2)(a) should also apply to cases where the validity of a contract, although it is concluded, depends on further action of the parties, as

is the case, for instance, in a sale on approval. In such a case the withdrawal period should not begin before the contract is finally valid (cf. BGH (GERMAN Supreme Court), judgment of 1 March 2004, *Neue Juristische Wochenschrift-Rechtsprechungsreport* (NJW-RR) 2004, 1058 et seq.).

Illustration 1

Even before conclusion of a sales contract, the seller gives the buyer adequate notice of the buyer's right of withdrawal in case the contract is concluded. The withdrawal period starts to run on the date of the conclusion of the contract and not on the date of the notice of the right of withdrawal.

The requirements for adequate notification of the right to withdraw (paragraph (2)(b)) are laid down in II.-5:104 (Adequate notification of the right to withdraw). It is solid ground in Community law and the laws of the Member States that the withdrawal period is at least substantially extended if the entitled party does not receive adequate information of the right to withdraw. Paragraph (2)(c) of the present Article reaches this result by stipulating that the normal withdrawal period of fourteen days does not begin before the receipt of such adequate notification. The provision has a double function. On the one hand, it protects the entitled party, who has not been adequately informed of the right to withdraw, by granting a much longer period of one year, giving this party the chance to learn otherwise about the right to withdraw during the extended period. On the other hand, the rule is a sanction against the party who did not inform the other party adequately of the right of withdrawal. The sanction results in a substantial extension of the withdrawal period, which is, from the perspective of this party, a period of pending uncertainty whether the contractual relationship will continue to exist and whether there will have to be restitution.

Illustration 2

A party is entitled to withdraw from a contract. The goods are delivered, but the other party fails to indicate, in the notification of the right to withdraw, the name of the person to whom the notice of withdrawal should be addressed. The entitled party can withdraw even after the expiry of fourteen days, and loses the right of withdrawal after one year has passed.

For contracts where the subject matter is the delivery of goods, paragraph (2)(c) postpones the beginning of the withdrawal period to the time when the goods are received. This rule follows the model of Art. 6(1) Sentence 3 of the Distance Selling Directive 1997/7/EC, but broadens it to all cases where one party has a right to withdraw. It is not sufficient that the other party has just fulfilled the obligation to dispatch the goods, as the time of receipt may be considerably later than the time of dispatch. The rationale of this rule follows from one of the core functions of the right to withdraw, which is to give the entitled party additional time for reflection. Where goods are delivered under the contract, the rule ensures that the entitled party can inspect the goods during the full duration of the fourteen day period in order to make an informed decision whether to stick to the contract or to withdraw. This time for inspection is typically needed in many situations where withdrawal rights exist, because, as in the case of

distance selling or of an order made at the doorstep, there was usually no opportunity to see the good at the time of the placing of the order.

The phrase “unless provided otherwise” in paragraph (2) indicates that there may be other provisions in these rules, which make the beginning of the withdrawal period dependent on other events. This is the case in II.–3:107 (Remedies for breach of information duties) paragraph (1) which also prevents the period from beginning if certain pre-contractual information duties other than the duty to inform on the right to withdraw have been infringed. Moreover, II.–5:101 (Scope and mandatory nature) does not prevent agreements on the beginning of the withdrawal period which are in favour of the entitled party and which therefore take precedence over the rules in paragraph (2).

D. ‘Long stop’ maximum time limit

For the case where the ordinary fourteen day withdrawal period under paragraph (2) does not begin at all, paragraph (3) stipulates a ‘long stop’ maximum period of one year. This period begins at the time of the conclusion of the contract and is to be computed according to the rules laid down in Annex 2. Also in the (unlikely) case of a pending offer made by a party entitled to withdraw from the contract, the ‘long stop’ withdrawal period will never begin, as there is no contract concluded. Hence, the entitled party has an eternal right to withdraw in this case. In the other cases of paragraph (2) (i.e. the lack of adequate notification or the – unlikely – situation of a delivery of goods later than one year after the conclusion of the contract), the right to withdraw ceases to exist after one year.

Illustration 3

The other party delivers the goods, but the anticipated conclusion of the contract has not yet materialised (e.g. because applicable form requirements have not yet been complied with). The entitled party can withdraw at any time. As the withdrawal period does not start to run before the conclusion of the contract, the maximum time limit of one year does not apply to this situation.

The uniform one year ‘long stop’ period is not based on communalities of Community law and the laws of the Member States. For most legal orders it is an innovation which follows the model of Finnish law. The reason for this suggested innovation is the very incoherent regulation of this question in Community law, and the even greater incoherence in the Member States’ laws. Whereas the Doorstep Selling Directive 1985/577/EEC, the Financial Services Distance Selling Directive 2002/65/EC and the Life Assurance Directive 2002/83/EC do not provide for a maximum time limit, the Distance Selling Directive 1997/7/EC and the Timeshare Directive 1994/47/EC do. Both of these Directives establish a maximum time limit of three months (plus the ordinary withdrawal period). With regard to the Doorstep Selling Directive the ECJ held that the Member States may not provide for a maximum time limit if this is not intended by the relevant Directive (cf. ECJ 31 December 2001 C-481/99 – *Heininger*). In theory, this leads to an eternal right of withdrawal, which is only limited by general prescription rules (if they apply) or by the application of the principle of good faith and fair dealing. Such

extreme differences do not seem to be justified by the peculiarities of the individual Directives. Therefore a uniform maximum period seemed desirable in order to simplify the law and to make it more coherent. An eternal period, although rather consumer friendly, did not seem advantageous, because such a right would be alien to contract law principles and would lead to a lot of uncertainty. The one year maximum period is a compromise that balances the existing rules. It simultaneously extends the ‘three months plus periods’ (which are perhaps too short) of several Directives but it considerably shortens the eternal period. In case a legislator wants to stipulate a shorter or longer maximum period for particular rights of withdrawal, this can be provided in specific legislation.

Paragraph (3) of this Article overlaps with II.–3:107 (Remedies for breach of information duties) paragraph (1) in so far as a ‘long stop’ maximum period of one year is provided for in both. The two provisions are nevertheless not identical, because their scope of application is different. II.–3:107 (Remedies for breach of information duties) paragraph (1) also prevents the commencement of the ordinary fourteen day withdrawal period for cases where the information to be given under II.–3:103 (Duty to provide information when concluding contract with a consumer who is at a particular disadvantage), which also includes information other than the notification on the right to withdraw, has not been provided. Hence, the ‘long stop’ maximum period regulated in II.–3:107 (Remedies for breach of information duties) paragraph (1) is necessary to avoid an eternal period in these cases.

E. Dispatch rule

Paragraph (4) lays down that the entitled party merely has to dispatch the notice of withdrawal within the period in order to comply with the time limit. It is unnecessary for the notice to reach the addressee within the period. This rule is in line with similar provisions in several of the Directives regulating individual withdrawal rights (e.g. Art. 5(1) Sentence 2 Doorstep Selling Directive 1985/577/EEC; Art. 5 No. 2 Sentence 2 Timeshare Directive 1994/47/EG). The purpose of this provision is to protect the entitled party by giving this party the benefit of the full withdrawal period for reflection, rather than having to bear the risk and the burden of proof associated with a delay in the transmission of the notice.

Illustration 4

A party is entitled to withdraw from a contract. The entitled party writes a letter to the other party which contains notice of withdrawal. The entitled party places this letter in the mail box on the last day of the withdrawal period. The withdrawal notice reaches the other party three days later. As the notice was dispatched within the withdrawal period, and actually reached the other party, withdrawal is effective.

F. Risk of loss of the notice of withdrawal

Paragraph (4) also distributes the risk between the parties in case a notice of withdrawal, which has been dispatched before the end of the period, does not reach the addressee. According to its wording, paragraph (4) seems to be only a ‘timeliness rule’, not a ‘lost letter’ or ‘mailbox rule’. However, the question is put too simply. In case of a lost letter (or other form of communication), which has been dispatched in time, the present Article answers three questions, namely (i) whether the withdrawal is effective despite the loss of the letter, (ii) whether it has been exercised in time, if a second letter is dispatched after the end of the period, and (iii) at which point in time the withdrawal becomes effective. Question (i) is not a question: If the addressee never receives notice of withdrawal, there is, of course, no withdrawal. Question (ii) is the core issue, namely how to solve the case, when the entitled party writes a second letter which is dispatched after the end of the period, informing the other party of the lost notice of withdrawal and manages to prove that he or she has dispatched the first notice of withdrawal in time. As paragraph (4) of this Article seeks to disburden the entitled party from the risk of delayed transmission of the notice, it would be odd to distinguish between a delay caused by an unusually slow transmission and a delay caused by the fact that the letter got lost and a second letter had to be sent. Therefore paragraph (4) should lead to the result that withdrawal is effective if the second letter (or other form of communication) actually reaches the other party, even if this second letter – other than the first – has been dispatched after the end of the withdrawal period (for the same result cf. OLG Dresden (GERMAN Court of Appeal), 20 October 1999, *Neue Juristische Wochenschrift-Rechtsprechungsreport* (NJW-RR) 2000, 354).

With regard to question (iii), when the withdrawal becomes effective, II.–1:106 (Notice) paragraph (3) applies. According to that Article a notice becomes effective “when it reaches the addressee”. Thus, in the ‘lost letter case’ the withdrawal will not be effective before the second letter reaches the addressee. The opposite rule, according to which notice (even if it has been lost) becomes effective at the time at which it would have arrived in normal circumstances, can be found in III.–3:106 (Notices relating to non-performance). But that Article concerns cases of non-performance, i.e. cases where the addressee has failed to perform an obligation under the contract. As explained above under A., it is a core characteristic of withdrawal rights, that there is typically no legal reason e.g., non-performance of obligations under the contract. Moreover, the rule on the effects of withdrawal (II.–5:105) reaches more convincing results if the withdrawal is not effective before the notice actually reaches the addressee. Therefore, III.–3:106 (Notices relating to non-performance) is a rule for a specific case. There is no reason to deviate from the general rule in II.–1:106 (Notice) paragraph (3). The withdrawal becomes effective, when the notice reaches the addressee.

Illustration 5

A party is entitled to withdraw from a contract. The notice of withdrawal is dispatched within the withdrawal period, but the letter gets lost in the mail and therefore never reaches the other party. As the risk of loss of the notice of withdrawal is borne by the entitled party, the withdrawal is not effective. But if

the entitled party writes a second letter in order to replace the first, the withdrawal becomes effective when this letter reaches the addressee, even if it is dispatched after the end of the withdrawal period.

II.–5:104: Adequate notification of the right to withdraw

An adequate notification of the right to withdraw requires that the right is appropriately brought to the entitled party’s attention, and that the notification provides, in textual form on a durable medium and in clear and comprehensible language, information about how the right may be exercised, the withdrawal period, and the name and address of the person to whom the withdrawal is to be communicated.

COMMENTS

A. Duty to inform of the right to withdraw

The Article, which regulates when a notification is adequate, presupposes the existence of a requirement or duty to inform the entitled party of its right to withdraw by such notification. A requirement of notification follows indirectly from II.–5:103 (Withdrawal period) paragraph (2)(b). A duty to notify is explicitly laid down in II.–3:103 (Duty to provide information when concluding contract with a consumer who is at a particular disadvantage). II.–3:103 also clarifies that the notification of the right to withdraw must be provided within a reasonable time before the conclusion of the contract, if that is appropriate in the circumstances. The explicit reference to the present Article at the end of II.–3:103 (Duty to provide information when concluding contract with a consumer who is at a particular disadvantage) paragraph (1) further clarifies that the notification of the right to withdraw must be in textual form on a durable medium and must contain all the items listed in the present Article, if that is appropriate in the circumstances. The requirements for the adequacy of the notification have been extracted from the corresponding provisions of the Doorstep Selling Directive 1985/577/EEC, the Timeshare Directive 1994/47/EC, the Distance Selling Directive 1997/7/EC, the Financial Services Distance Selling Directive 2002/65/EC and the Life Assurance Directive 2002/83/EC.

It should be noted that the present Article is not applicable to the duties imposed on businesses by II.–3:102 (Specific duties for businesses marketing goods or services to consumers) paragraphs (1) and (2). The information on the right to withdraw to be given to the entitled party under II.–3:102 (Specific duties for businesses marketing goods or services to consumers) can be limited to the fact that a right of withdrawal exists. The business does not need to provide all the information items listed in the present Article. It also does not need to provide the information in textual form on a durable medium. As II.–3:102 (Specific duties for businesses marketing goods or services to consumers) paragraph (1) states, it is sufficient that the information is given, “so far as is practicable having regard to all the circumstances and the limitations of the communication medium employed”. It also follows from II.–3:102 (Specific duties for businesses marketing

goods or services to consumers) paragraph (2) that the information on the right to withdraw has to be given within the commercial communication (which could be, e.g., a TV spot); thus by the means the communication medium allows, but not necessarily in textual form on a durable medium.

B. Two step information can be necessary

If it is not appropriate in the circumstances to provide complete notification or to provide it in textual form on a durable medium before the conclusion of the contract (e.g. TV spots and subsequent conclusion of contracts over the phone), the business must inform the entitled party twice about the right to withdraw. Firstly, within reasonable time before the conclusion of the contract, the entitled party must generally be informed of the right to withdraw in the appropriate way having regard to the communication channel used under II.–3:103 (Duty to provide information when concluding contract with a consumer who is at a particular disadvantage). Secondly, according to II.–3:106 (Clarity and form of information) paragraph (3), the information must in any case be confirmed in textual form on a durable medium at the time of the conclusion of the contract. If the first information was only general and did not contain all the information items necessary under the present Article, it must also be completed, at the latest, at this time in order to avoid the consequence of the extended withdrawal period under II.–5:103 (Withdrawal period) paragraph (2)(b). Such a ‘two step’ duty to inform the entitled party of his or her right to withdraw is in line with the Directives that confer rights of withdrawal upon the consumer. It is in particular modelled on Art. 4 and Art. 5 of the Distance Selling Directive 1997/7/EC.

C. Sanctions for the infringement of the duty to provide adequate notification

If the other party does not give adequate notification as laid down in the present Article, the withdrawal period of one year according to II.–5:103 (Withdrawal period) paragraph (3) applies. Moreover, the withdrawing party is not liable for any diminution in value caused by normal use of goods received under the contract (cf. II.–5:105 (Effects of withdrawal) paragraph (4)) and can even be entitled to damages as provided for in II.–3:107 (Remedies for breach of information duties) paragraph (2).

Illustration 1

In the autumn A orders an electric heater by mail. He has not been adequately informed of his right to withdraw. A few days after the receipt of the heater he notices that it consumes much more energy than another model with the same thermal output available on the market for the same price. As A does not know about his right to withdraw, he uses the heater despite the high energy consumption during the winter. In spring, A learns by chance about his right to withdraw and withdraws. A can claim damages for the loss, which are the higher energy costs, under II.–3:107 (Remedies for breach of information duties) paragraph (2). This claim may in particular reduce or even outweigh the

counterclaim of the business for compensation for the use of the heater under II.–5:105 (Effects of withdrawal) paragraph (2) and III.–3:514 (Use and improvements).

In addition to such inter-party consequences, an infringement of the duty to provide adequate notification of the right to withdraw can lead to preventative proceedings or fines under the applicable unfair commercial practices law.

D. Appropriately brought to the entitled party's attention

The duty to bring the notification of the right to withdraw appropriately to the entitled party's attention requires the business to make some reasonable effort to emphasise or highlight in particular the information on the right to withdraw. The notification of the withdrawal right must not be hidden in unspecified other information. It is not sufficient to state the right of withdrawal in standard terms in such a way that it will most likely not be read by the entitled party. Appropriate means are, for example, bold letters or a frame on an order form close to the space for the client's signature. Also a highlighted paragraph in the standard terms may suffice.

Illustration 2

A party has the right of withdrawal. The complete information required for an adequate notification is provided within one of many standard clauses. This can not be regarded as an adequate notification as the information is not appropriately brought to the entitled party's attention.

E. Textual form on a durable medium

The notion of textual form on a durable medium is defined in I.–1:105 (Meaning of “in writing” and similar expressions) paragraphs (2) and (3). Examples are printed paper or an e-mail. An oral notification – e. g. in the situation of a doorstep sale – or a leaflet which is only shown and not handed over to the entitled party is not sufficient. Notification just on a HTML page on the internet which can be downloaded or stored by the computer user is also not sufficient because the notification is just provided in textual form, but not on a durable medium. The possibility that the addressee produces a durable medium, e.g. by storing the notification on the hard drive or by printing it out, is not the ‘provision’ of a durable medium.

F. Clear and comprehensible language

The requirement of using clear and comprehensible language in the notification is also lifted from the relevant Directives. The notification must be drafted in a way that the “average consumer who is reasonably well-informed and reasonably observant and circumspect” in the sense of the ECJ case law can understand it (cf. ECJ, C-210/96, *Gut Springenheide*). In particular, the information must not be ambiguous as this could deter the entitled party from exercising the right.

G. Necessary content of the notification

The Article limits the information the notification must contain to three elements, namely (i) how the withdrawal right may be exercised, (ii) the withdrawal period, and (iii) the name and address of the person to whom the withdrawal is to be communicated. Compared with some more detailed requirements in individual Directives (cf. e.g. Art. 3(3) Financial Services Distance Selling Directive 2002/65/EC) and the even more specific requirements in the laws of some Member States, this Article only provides for a common core of the compulsory information items which can be found in EC and national legislation on the duty to inform of withdrawal rights.

There are two reasons for the approach adopted. The first is that the Article is part of a general regulation of withdrawal rights. It therefore does not exclude more specific provisions with regard to individual withdrawal rights (e.g. in the field of financial services such as consumer credit, information on the consequences of withdrawal might be needed). The second reason is that a more modern approach seeks to limit the number of necessary information items to core information ('information chunks') in order to avoid information overkill on the side of the addressee. This approach is in line with at least several of the Directives and laws of the Member States. Hence, the purpose of this Article is to ensure that the entitled party has a basic knowledge of the right to withdraw and the most important information necessary in order to withdraw. The purpose of the notification is not to create a comprehensive knowledge basis for reflection on the question whether to exercise the right of withdrawal or not. In particular, the following information does not need to be provided: the calendar dates when the withdrawal period begins and ends, the method of its calculation (including the influence of public holidays and Saturdays), the fact that no reasons need to be given, the effects of withdrawal, also information with regard to restitution. It would be very difficult for the business to provide this information correctly. At the same time the notification would become rather long and complicated to understand.

H. How the right may be exercised

The information on how the right may be exercised must make clear, ideally with the help of examples, that there are no formal requirements, thus, that the entitled party can withdraw over the phone, by email, fax, letter, or by returning the goods received under the contract. It need not be expressly stated that no reasons have to be given.

I. Withdrawal period

This information must include the length of the withdrawal period (i.e. fourteen days), the event(s) which trigger(s) the start of the period and that the deadline is met if the notice of withdrawal has been dispatched before the end of the period. Adequate notification of the right to withdraw does not include that the entitled party must also be informed of the dates on which the withdrawal period starts and ends. Nevertheless, if any date that is

given turns out to be earlier than the correct end date of the period, the notification is not adequate. The incident that triggers the start of the withdrawal period is not sufficiently indicated if the notification of the right of withdrawal does not make clear whether the withdrawal period begins at the time of conclusion of the contract or at the time when the entitled party receives adequate notification of the right to withdraw from the other party or at the time when the goods are received.

Illustration 3

A party to a sales contract concluded at a distance merely gives the entitled party the information that she can withdraw within fourteen days after both the contract has been concluded and adequate notification of the right to withdraw has been received. The information that the withdrawal period does not begin before the goods have been received is missing. The notification is therefore not adequate.

J. Address of the person to whom the withdrawal is to be communicated

“Address” means the postal or geographical address under which the other party will actually receive an express notice of withdrawal or the goods. If the other party provides details of their company’s name, a PO Box number and the municipality in which the company is based, but fails to give more precise geographical indicators (e.g. the street name and house number), the requirements of this Article are not fulfilled. A PO Box number cannot be regarded as an address. Street name and house number are necessary parts of the address as this ensures that returned goods, in particular if they are bulky, actually reach the other party. Moreover, under some national mail systems it is also easier to get proof of the notice of withdrawal if it is sent to a geographical address (e.g. registered letter with return receipt). The requirement to indicate a geographical address is in line with the provisions in some of the Directives (cf. Art. 3(1)(1)(a) of the Financial Services Distance Selling Directive 2002/65/EC)

II.–5:105: Effects of withdrawal

(1) Withdrawal terminates the contractual relationship and the obligations of both parties under the contract.

(2) The restitutionary effects of such termination are governed by the rules in Book III, Chapter 3, Section 5, Sub-section 4 (Restitution) as modified by this Article, unless the contract provides otherwise in favour of the withdrawing party. Any payment made by the withdrawing party must be returned without undue delay, and in any case not later than thirty days after the withdrawal becomes effective.

(3) The withdrawing party is not liable to pay:

(a) for any diminution in the value of anything received under the contract caused by inspection and testing;

(b) for any destruction or loss of, or damage to, anything received under the contract, provided the withdrawing party used reasonable care to prevent such destruction, loss or damage.

(4) The withdrawing party is liable for any diminution in value caused by normal use, unless that party had not received adequate notice of the right of withdrawal.

(5) Except as provided in this Article, the withdrawing party does not incur any liability through the exercise of the right of withdrawal.

COMMENTS

A. Content and context

The Article seeks to provide for a complete set of rules for the effects of withdrawal on the contractual obligations and on the unwinding of the contractual relationship. Paragraph (1) terminates the obligations of both parties for the future, but says nothing on the restitutionary effects. Paragraph (2) refers to the rules on restitution after the termination of a contractual relationship under Book III Chapter 5 Section 5, i.e. the rules on termination for non-performance. Paragraphs (3) and (4) contain some modifications of the restitutionary effects in favour of the withdrawing party. Finally, paragraph (5) clarifies the obvious, namely that the withdrawal as such does not lead to any liability of the withdrawing party for non-performance of the contractual obligations.

B. Termination of the obligations under the contract

Paragraph (1) provides that the withdrawal has the effect of terminating the contractual relationship and the obligations of both parties under the contract for the future. The withdrawal releases both parties from any obligations to perform. Any claim for performance of the contractual obligations becomes unjustified when the withdrawal becomes effective. The precise moment when the withdrawal becomes effective is the moment when the notice of withdrawal reaches the addressee in the sense of II.–1:106 (Notice) paragraph (3).

If the entitled party has already withdrawn from its offer to conclude a contract before the contract has been concluded, the offer ceases to have effect. The present Article does not provide this expressly, but this result follows from II.–5:103 (Withdrawal period) paragraphs (1) and (2)(a), which make clear that the entitled party can also withdraw from an offer before the conclusion of the contract.

The present Article presupposes that the parties to a contract from which one of them can withdraw have a right to claim performance of the contractual obligations during the withdrawal period. Such a contract is valid and enforceable despite the existence of the right of withdrawal. This seems to be in line with the Distance Selling Directive 1997/7/EC (cf. Art. 6(1) Sentence 3 of this Directive). However, the validity and enforceability of a contract during the withdrawal period may differ from the solution chosen in some Member States where the contract may be considered as not being concluded as long as the withdrawal period is pending (cf. e.g. Art. 89 of the BELGIAN Unfair Trade Practices Act with regard to doorstep selling).

C. Restitutionary effects of withdrawal

In general, the provisions on the restitution after the termination of a contractual relationship under III.–3:511 (Restitution of benefits received by performance) to III.–3:515 (Liabilities arising after time when return due) apply. Thus, both parties must return any benefit received in the course of the performance of the obligations under the contract. Each party must do so at its own expense. The contract can provide otherwise in favour of the party entitled to withdraw from the contract. Payments received must be repaid. Other benefits, if transferable, must be returned by transferring them, unless such a transfer would cause unreasonable expense. In that case, or if the benefit is not transferable at all, the recipient is obliged to pay the value of the benefit to the other party.

These model rules do not contain an express rule on the question of which party has to bear the expenses for the initial sending of the benefit (e.g. goods ordered at a distance) and for their return. This question is answered rather differently within the Member States, whereas the Directives applicable do not contain specific rules. Paragraph (2) of the present Article leads to the result that, in case of withdrawal, it is in any case the sender who will finally have to bear the expenses for shipment, e.g. a distance seller must bear the costs for shipping the goods to the client, but the client must bear the costs for sending them back (unless otherwise agreed or unless returning the goods would be unreasonable). This follows, for the seller, from the fact that the seller will have to return all payments made by the client in performing the contractual obligations under III.–3:511 (Restitution of benefits received by performance) paragraph (2). The client is obliged to return the goods by transferring them under paragraph (3) of the aforesaid Article. This obligation to transfer includes the costs of transport.

D. Return of payments without undue delay

Sentence 2 of paragraph (2) seeks to solve a problem which often surrounds returning goods and reimbursement. The provision that any payment made by the withdrawing party must be returned without undue delay, and in any case not later than thirty days after the withdrawal becomes effective, corresponds to Art. 6(2) of the Distance Selling Directive 1997/7/EC. The main function is to secure repayment at the latest within thirty days and to exclude a right to withhold performance against the withdrawing party under III.–3:401 (Right to withhold performance of reciprocal obligation) after the expiry of the thirty day period. The reason is that the party who has received a notice of withdrawal (i.e. usually a business, e.g. a distance seller of IT hardware) and who had also already received the price, might block the restitution by exercising a right to withhold performance. As the withdrawing party (i.e. usually a consumer) also has a right to withhold performance (i.e. returning the goods) in such a case, the contractual relationship might not be unwound for a long time, e.g. until the end of litigation. This could factually secure the economic profit of the other party (i.e. the seller) despite the withdrawal, as the withdrawing party might have to pay, e.g., for the reduction in value of the benefit received (e.g. a laptop) and for the value of any use made of it under III.–3:513 (Payment of value of benefit) to III.–3:515 (Liabilities arising after time when

return due). The present Article avoids the possible deadlock by creating the obligation to return any payments received from the withdrawing party in advance. The reason is that, in the long run, the other party (i.e. the seller), if it has received the price, might have a greater interest in blocking the unwinding of the contract. Moreover, the party entitled to withdraw should not be discouraged from exercising that right by the factual need to return the goods received in advance of any return of payment. It should be noted that this applies only in so far the goods received still exist and are to be actually returned by transfer. If the recipient of the goods (e.g. because they do not exist any more) is obliged to pay their value, the rules on set-off (Book III Chapter 6 Section 1) apply. The same is true for any claim to pay for reduction in value or use of the goods where the goods still exist.

The thirty day period starts running when the withdrawal becomes effective, i.e. when the notice of withdrawal reaches the addressee (and not from the moment when it is dispatched). The period is to be calculated according to the rules in Annex 2.

E. Liability for loss, damage or diminution in value

Paragraphs (3) and (4) modify the general rules on restitution with regard to the specific function of withdrawal rights. These provisions are based on the principle which is implied in some provisions (e. g. in Art. 6(1) and (2) Distance Selling Directive 1997/7/EC) and in the jurisprudence of the ECJ – particularly case C-350/03 – *Schulte* and C-229/04 – *Crailsheimer*, that the entitled party must not be deterred from exercising the right of withdrawal by its factual consequences. On the other hand, abuse of the right of withdrawal must be avoided and the other party must not be made to bear excessive risks. Paragraphs (3) and (4) seek to balance these aspects.

Paragraph (3)(a) deals with the delicate problem of diminished value caused by inspection and testing of the goods. As the right of withdrawal is meant to enable the entitled party to make an informed choice, there should be no disincentive to inspecting and testing the goods. However, inspection and testing must be reasonable and appropriate. Any use that goes beyond the possibilities a consumer would have had in a shop buying the same goods should not fall under this rule.

Illustration 1

A woman buys clothes by mail order, unpacks the clothes and tries them on. She decides they do not flatter her and sends them back. She does not have to compensate for the damage caused by unpacking and trying on the clothes.

Paragraph (3)(b) excludes liability for loss of or damage to anything received under the contract, provided the entitled party used reasonable care to prevent such loss or damage. What can be considered to be reasonable care may vary depending on the circumstances. One of the circumstances that must be taken into account is whether the entitled party has been informed of the existence of a right of withdrawal. The standard of care which is considered to be reasonable will be lower if the entitled party was not aware of the possibility of returning the goods. If the consumer has not been informed of his or her

right of withdrawal, the standard of care is the *diligentia quam in suis*, i.e. the level of care which the consumer exercises in his or her own affairs. However, if the consumer was informed of the right of withdrawal, no such privilege applies.

Illustration 2

A party buys a camera on the internet. The camera is delivered, but on the same day the buyer's house is struck by lightning and burns down. The camera is destroyed. The buyer can still withdraw from the contract and the seller will have to return the price although the buyer will be unable to return the camera.

Paragraph (4) deals with liability for the diminished value of the goods due to their normal use. If the withdrawing party was aware of the right to withdraw from the outset, it was in that party's power to use the goods during the withdrawal period only in a way that no diminution of value other than by inspection and testing occurred. So even a diminution of value by normal use (e.g. walking with shoes) must be compensated. But, if the entitled party has not been informed of the existence of a right of withdrawal, the balance of interests leads to a different solution: the entitled party will then not be held liable for diminished value due to normal use.

Illustration 3

A party buys a flat screen and uses it for a number of days, thus exceeding what is necessary to test it. The buyer then withdraws from the contract. He will have to return the screen at his own costs, and is liable to compensate for the loss of value, or damage caused to the screen caused by its use (cf. OGH (AUSTRIAN Supreme Court), 27 September 2005, 1 Ob 110/05s). No such compensation is due if the buyer has not been informed of his right of withdrawal.

In any event, paragraph (5) makes it clear that the withdrawing party does not incur any other liability because of the exercise of the right of withdrawal. No damages or penalty can be imposed on the withdrawing party for the sole reason that he or she has exercised a right of withdrawal. The ECJ held in Case C-423/97 – *Travel Vac* that a contract must not provide that the consumer must pay a specified lump sum for damage caused to the business on the sole ground that the consumer has exercised a right of withdrawal.

II.-5:106: Linked contracts

(1) If a consumer exercises a right of withdrawal from a contract for the supply of goods or services by a business, the effects of withdrawal extend to any linked contract.

(2) Where a contract is partially or exclusively financed by a credit contract, they form linked contracts, in particular:

(a) if the business supplying goods or services finances the consumer's performance;

(b) if a third party which finances the consumer's performance uses the services of the business for preparing or concluding the credit contract;

(c) if the credit contract refers to specific goods or services to be financed with this credit, and if this link between both contracts was suggested by the supplier of goods or services, or by the supplier of credit; or

(d) if there is a similar economic link.

(3) The provisions of II.-5:105 (Effects of withdrawal) apply accordingly to the linked contract.

(4) Paragraph (1) does not apply to credit contracts financing the contracts mentioned in paragraph (2)(f) of the following Article.

COMMENTS

A. Extension of the withdrawal right to linked contract

The contract from which the consumer withdraws often does not stand alone. A credit contract may have been concluded to finance the price for goods or services. Specific provisions are then needed to determine the effect of withdrawal from one contract on linked transactions. The effect on linked contracts determines to a large extent the effectiveness of a right of withdrawal. Therefore, the present Article extends the effects of the withdrawal from a contract to any linked contract.

The Article is modelled on Art. 6(4) Distance Selling Directive 1997/7/EC. Similar rules regarding linked contracts are provided for in Art.6(7) Financial Services Distance Selling Directive 2002/65/EC, Art. 7 Timeshare Directive 1994/47/EC, Art. 7 of the Proposal for a Revision of the Timeshare Directive (COM (2007) 303) and Art. 3(1) and 14 of the Second Revised Proposal for a Consumer Credit Directive (COM (2005) 483). In contrast, the Doorstep Selling Directive 1985/577/EEC has no explicit provision on linked contracts.

The general rule on the fate of linked contracts avoids the uncertainty that presently governs the matter. Cases C-350/03 – *Schulte* and C-299/04 – *Crailsheimer* have illustrated that, in the absence of explicit provisions in a Directive, the general concept of effectiveness of Community law, in principle, cannot be relied on for determining the fate of linked contracts, as this remains a question of national law. In these cases, the effect which the withdrawal from a secured credit contract concluded in a doorstep selling situation has on the contract for the sale of immovable property was at stake. The ECJ held in *Schulte* that ‘although the Directive does not preclude national law from providing, where the two contracts form a single economic unit, that the cancellation of the secured credit contract has an effect on the validity of the contract for sale of the immovable property, it does not require such an effect in a case such as that described by the referring court’. The ECJ nevertheless did impose some limits on the discretion of the national legislator to determine the effects of the exercise of the right of withdrawal in case the necessary information with regard to the right of withdrawal had not been provided.

Paragraph (1) sets out the general principle. Paragraph (2) gives further guidance for the interpretation and application of the concept of “linked contracts” to linked credit contracts. Paragraph (3) makes it clear that the effects of withdrawal on the linked contract are the same as for the main contract. In order to avoid abuse for the purpose of speculation, paragraph (4) provides for an exception regarding contracts for goods or services whose price depends on fluctuations in the financial market as defined in II.–5:201 (Contracts negotiated away from business premises) paragraph (2)(f).

Withdrawal from the main contract automatically entails withdrawal from the linked contract. No separate notice of withdrawal is needed. It is a different question whether in cases where the supplier under the main contract is not the same person as the supplier under the linked contract, one may want to consider imposing an obligation on the supplier under the main contract to inform without delay the supplier under the linked contract of the notice of withdrawal. The present Article which only deals with the relation between the supplier(s) and the consumer, does not provide an answer to this question.

Illustration 1

Consumer A is contacted on her doorstep by a salesman of business B. She concludes a contract for the installation of a burglary alarm by business B as well as a separate five year contract for the maintenance of this system with business C, the latter being represented by business B. She withdraws from the contract for the installation of the alarm by sending a registered letter to business B. As the maintenance contract is a linked contract in the sense of paragraph (1) of the present Article, the consumer will automatically no longer be bound by the maintenance contract.

B. The concept of “linked contracts”

For two contracts to be considered as “linked contracts” under paragraph (1) it is necessary that the connection between the two contracts is close enough to justify the solution that the withdrawal from one contract has legal consequences for the other contract. This is the case if the two contracts form an economic unit from an objective point of view. It is the close economic link from the commercial point of view, and not the exact legal constellation, that determines whether the contracts can be considered to form a unit. This concept leaves some discretion to the judge who will have to decide, on the basis of objective factors, depending on the specific circumstances of the case, whether the contracts can be considered to form linked contracts. This will be so when both contracts are linked in such a way that one contract could not have been concluded without the other or when one contract only has reason to exist because of the existence of the other contract. Reference to objective factors bars businesses from avoiding this effect on a linked contract by pointing out to consumers that they cannot expect the contracts to be linked. The criteria specifically set out in paragraph (2) for credit contracts are also to be taken into account in the application of paragraph (1).

Linked contracts will most often be credit contracts financing sales contracts, but it is not excluded that other contracts, such as e.g. maintenance contracts (cf. Illustration 1) or insurance contracts are also linked contracts. Contracts between the same parties can form linked contracts. It is also possible that contracts in a tripartite relationship form linked contracts. In particular, this may be the case if a third party provides goods or services to a consumer on the basis of a contract with a business with whom the consumer has concluded the main contract.

C. Linked credit contracts

Paragraph (2) provides a non-exhaustive list of situations in which a credit contract forms a linked contract with a contract that is wholly or partially financed by this credit contract. The elements in this list, which give further guidance for the interpretation of the term “economic unit”, are based on GERMAN CC § 358 and the Proposal for a Directive on Consumer Credit (cf. Art. 3 lit. (l) of the Draft, COM (2005) 483), except that the aforementioned list is exhaustive.

Illustration 2

A consumer is contacted by car dealer ‘CNX’ and concludes in her house a contract for the sale of a CNX car. A credit contract between the consumer and CNX-Bank for financing the sale of the car is concluded on the same day, and the consumer fills out the forms with the help of car dealer CNX. The contract for the sale of the car and the contract financing that sale are linked contracts (cf. LG Braunschweig (GERMAN Regional Court), judgment of 16 June 1994, 7 S 7/94). Withdrawal from the contract for the sale of the car will entail automatic withdrawal from the credit contract.

D. Legal consequences of the withdrawal for the linked contract

The legal consequences of withdrawal from the main contract for the linked contract are determined by paragraph (3). This rule refers to II.–5:105 (Effects of withdrawal) which deals with the effects of withdrawal on the obligations of the parties that stem from the main contract. Withdrawal has the same effect on the obligations stemming from the linked contract. It follows from II.–5:105 (Effects of withdrawal) in conjunction with paragraph (3) of the present Article that the obligations to perform the linked contract are terminated (II.–5:105 paragraph (1)) and that both parties have to return what they received under the linked contract (II.–5:105). Payments received under the linked contract will have to be returned in accordance with sentence 2 of II.–5:105 paragraph (2). Liability for damages to goods that may have been received under the linked contract will be governed by II.–5:105 paragraphs (3) and (4).

E. Exception for speculative contracts

The present Article does not exclude that withdrawal from a credit contract (as may be, for instance, possible under the future Consumer Credit Directive) may have consequences for a linked sales contract. Speculation by the consumer should, however, be excluded. Therefore, if a consumer can withdraw from a credit contract that forms a linked contract with a contract for the supply of goods or services whose price depends on fluctuations in the financial market which are outside the supplier’s control and which

may occur during the withdrawal period under II.-5:201(Contracts negotiated away from business premises), paragraph (2)(f), withdrawal from the credit contract will not affect this linked speculative contract.

Section 2: Particular rights of withdrawal

II.-5:201: Contracts negotiated away from business premises

(1) A consumer is entitled to withdraw from a contract under which a business supplies goods or services, including financial services, to the consumer, or is granted a personal security by the consumer, if the consumer's offer or acceptance was expressed away from the business premises.

(2) Paragraph (1) does not apply to:

- (a) a contract concluded by means of an automatic vending machine or automated commercial premises;*
- (b) a contract concluded with telecommunications operators through the use of public payphones;*
- (c) a contract for the construction and sale of immovable property or relating to other immovable property rights, except for rental;*
- (d) a contract for the supply of foodstuffs, beverages or other goods intended for everyday consumption supplied to the home, residence or workplace of the consumer by regular roundsmen;*
- (e) a contract concluded by means of distance communication, but outside of an organised distance sales or service-provision scheme run by the supplier;*
- (f) a contract for the supply of goods or services whose price depends on fluctuations in the financial market outside the supplier's control, which may occur during the withdrawal period;*
- (g) a contract concluded at an auction;*
- (h) travel and baggage insurance policies or similar short-term insurance policies of less than one month's duration.*

(3) If the business has exclusively used means of distance communication for concluding the contract, paragraph (1) also does not apply if the contract is for:

- (a) the supply of accommodation, transport, catering or leisure services, where the business undertakes, when the contract is concluded, to supply these services on a specific date or within a specific period;*
- (b) the supply of services other than financial services if performance has begun, at the consumer's express and informed request, before the end of the withdrawal period referred to in II.-5:103 (Withdrawal period) paragraph (1);*
- (c) the supply of goods made to the consumer's specifications or clearly personalised or which, by reason of their nature, cannot be returned or are liable to deteriorate or expire rapidly;*
- (d) the supply of audio or video recordings or computer software*
 - (i) which were unsealed by the consumer, or*

- (ii) which can be downloaded or reproduced for permanent use, in case of supply by electronic means;*
- (e) the supply of newspapers, periodicals and magazines;*
- (f) gaming and lottery services.*

(4) With regard to financial services, paragraph (1) also does not apply to contracts that have been fully performed by both parties, at the consumer's express request, before the consumer exercises his or her right of withdrawal.

COMMENTS

A. Purpose and general scope

Paragraph (1) grants a consumer a right to withdraw from a contract if he or she expresses the offer or acceptance away from business premises. This right of withdrawal includes and slightly broadens the situations covered by Art. 5(1) Doorstep Selling Directive 1985/577/EEC, Art. 6(1) Distance Selling Directive 1997/7/EC and Art. 6(1) Financial Services Distance Selling Directive 2002/65/EC. Paragraphs (2), (3) and (4) reorganise the exceptions established in these Directives. The parties can agree to deviate from the exceptions of paragraphs (2) to (4) in favour of the consumer.

The provision only requires that the consumer actually concluded the contract outside of business premises. He or she need not be influenced or put under pressure by the business (Case C-423/97 – *Travel Vac*). Where the contract has been concluded with the help of an intermediary, it is also not a prerequisite that the business was aware, or should have been aware, that the consumer expressed his or her consent outside the normal business premises (Case C-299/04 – *Crailsheimer*).

Illustration 1

A consumer concludes a contract in the course of a visit by a salesman at his workplace, thus, outside of business premises. He decides to exercise the right of withdrawal. The business alleges that no undue pressure was exercised and that no aggressive sales practices were used in the circumstances. The consumer can exercise his right of withdrawal without having to prove that the opposite is true. It suffices that the consumer was in a situation described in paragraph (1) of the Article.

Illustration 2

A consumer is contacted at home by an independent agent acting on behalf of a business. The consumer signs a contract but later on exercises the right of withdrawal. The business claims that the consumer does not have a right of withdrawal as it was not aware that the agent had contacted consumers in a doorstep selling situation. The consumer has nevertheless a right of withdrawal. When a third party intervenes in the name of (or on behalf of) a business in the negotiation or the conclusion of a contract, the right of withdrawal is not subject to the condition that the business was or should have been aware that the contract

was concluded in circumstances such as those as described in the present Article. The legal position of the third party intervening in the conclusion of the contract is irrelevant for the application of the provisions protecting the consumer with respect to contracts concluded away from normal business premises (ECJ, Case C-299/04 – *Crailsheimer*; Commercial Court Leuven (BELGIUM), 1 June 1993, *Droit de la Consommation – Consumentenrecht* (DCCR) 1993-94, 527).

B. Slightly broader scope than the Directives

By the general rule in paragraph (1), some particular situations which are not covered by the three Directives mentioned above are also included (particularly the supply of goods and services on public streets and spaces). But this extension is in line with the situation in several Member States. Moreover, the general rule also allows a gap to be bridged in the current Directives: contracts that were negotiated in a doorstep situation but concluded afterwards by means of distance communication, for example by phone, were not covered by either of these Directives.

Paragraph (1), together with II.–5:103 (Withdrawal period) paragraph (2)(a) also implies that the period for withdrawal will be calculated differently for doorstep selling in comparison with the Doorstep Selling Directive 1985/577/EEC. Differing from these model rules and the rules in several Member States, this Directive does not require the goods to be delivered for the withdrawal period to start.

C. Justification of the withdrawal right

The Doorstep Selling Directive 1985/577/EEC concerns “contracts negotiated away from business premises” according to its official title. But the contracts within the scope of the Distance Selling Directive 1997/7/EC and the Financial Services Distance Selling Directive 2002/65/EC are not negotiated in the professional supplier’s business premises either. In these cases the consumer also expresses the intention to conclude the contract away from the professional supplier’s business premises. The rights of withdrawal granted under these Directives are concordant in this respect: they all recognise that risks exist for consumers when a contract is concluded away from the professional supplier’s business premises (‘out of shop contracts’). In these situations, it is assumed that consumers are usually less prepared for (or focused on) contractual negotiations, or are less informed about relevant contractual circumstances, than they are when they enter the professional supplier’s business premises. This is why a structural imbalance in the negotiations can arise. Each of the three Directives seeks to counter this imbalance by introducing a ‘cooling off’ period and a right of withdrawal for a specific situation.

The consumer buying on the doorstep or in another face-to-face situation outside of business premises is usually unable to compare products and prices. He or she will also often not be able to really inspect the goods offered on sale. The extra time provided by the withdrawal period allows him or her to compare products or services and prices. However, in doorstep selling and similar situations, the cooling off period does not only cure a problem of asymmetric information. Since in a doorstep selling situation

consumers are more easily influenced by aggressive sales practices, the cooling off period also allows consumers to consider the merit of the contract they concluded without being subject to the pressure exercised by a salesperson. This function of the cooling off period is relevant to both contracts for goods and contracts for services that are concluded in a doorstep situation.

In distance selling situations, asymmetric information is due to the fact that the contract is concluded by means of distance communication and that the consumer is unable to inspect or test the goods, contrary to what happens for contracts concluded at the seller's business premises. There is no problem here of pressure exercised by a business. The cooling off period allows the consumer to verify the quality or to test the goods as she or he could have done if the contract had been concluded at the business premises.

When contracting for (financial) services at a distance, the means of communication used are not the primary reason for an informational asymmetry. Concluding the contract at the business premises would generally not give much more information on the services offered. With respect to the distance selling of financial services, it is therefore harder to justify the right of withdrawal based on the situation in which the contract was negotiated. Financial services are intangible. They are a bundle of contractual rights and obligations. It is perfectly possible to provide all the information needed to be informed of this bundle of rights and obligations even through means of distance communication. A cooling off period does not seem to put the consumer in a much better position in any way. It may well be that there are advantages in receiving information on financial services in a face-to-face context, but the cooling off period does not remedy this possible shortcoming. If it is the complexity of the contract that justifies granting the consumer the right of withdrawal, one could argue that the consumer should have this right irrespective of the circumstances in which the contract was concluded. Finally, one could argue that a consumer may not be fully aware that a contract has been concluded through the clicking of a button, but the provisions in II.-3:105 (Formation by electronic means) should provide for sufficient protection in this regard. One may therefore want to reconsider whether the right of withdrawal is an efficient means at all for the purpose of enhancing consumer protection with respect to distance selling of services and of financial services in particular. However, the present Article reflects the current situation in EC law.

D. Exemptions from the right to withdraw

Paragraphs (2), (3) and (4) exempt certain contracts from the right to withdraw. These exemptions are necessary to achieve a balance between the interests of businesses and consumers. The consumer will not have the right of withdrawal if such a right would systematically lead to substantial losses for the business, or if such a right is likely to lead to abuse by the consumer or, if the protection afforded by the right of withdrawal is unnecessary for the specific contract. Whereas the exemptions in paragraph (2) are applicable to all contracts irrespective whether the contract has been concluded in a face-to-face situation or at a distance, paragraph (3) only applies to contracts concluded at a distance. Paragraph (4) only applies to financial services.

E. General exemptions (paragraph 2)

Paragraph (2)(a) and (2)(b) are based on Art. 3(1), 2nd and 3rd indent Distance Selling Directive 1997/7/EC. These exemptions for automatic vending machines and public payphones are transposed by the large majority of Member States and concern contracts that are not considered to be problematic. The same rationale underlies paragraph (2)(d) on regular roundsmen (in particular the English milkmen) which combines Art. 3(2)(b) Doorstep Selling Directive 1985/577/EEC and Art. 3(2), 1st indent of the Distance Selling Directive 1997/7/EC.

Paragraph (2)(c) on immovable property combines Art. 3(2)(a) of the Doorstep Selling Directive 1985/577/EEC and Art. 3(1), 4th indent of the Distance Selling Directive 1997/7/EC. These contracts are excluded as the genuine consent of parties to these contracts is warranted by other instruments of protection in accordance with national legislation, such as the conclusion of the contract before a public notary or other formal requirements. The counter-exception for tenancies, which stems from Art. 3(1) 4th indent Distance Selling Directive 1997/7/EC, comes in here and not under paragraph (3), because it is incoherent to grant the consumer a right to withdraw from rental contracts concluded in distance selling situations, but not to grant him or her the right of withdrawal for rental contracts concluded in one of the other situations covered by the present Article.

Paragraph (2)(e) corresponds to the current definition of distance contract in Art. 2(1) of the Distance Selling Directive 1997/7/EC and Art. 2(a) of the Financial Services Distance Selling Directive 2002/65/EC. Contracts in which the business uses means of distance communication as an exception to conclude the contract are outside the scope of application of these provisions. The term ‘means of distance communication’ refers to any means which, without the simultaneous physical presence of the supplier and the consumer, may be used for the conclusion of a contract between those parties in the sense of Art. 2(4) sentence 1 Distance Selling Directive 1997/7/EC.

F. In particular: exemptions for financial services (paragraphs (2) and (4))

Paragraph (1) clarifies that the right to withdraw is in principle also granted for contracts under which financial services are provided. The term ‘financial services’ means any service of a banking, credit, insurance, personal pension, investment or payment nature in accordance with Art. 2(b) of the Financial Services Distance Selling Directive 2002/65/EC.

Paragraph (2)(f) states an important exemption for many financial services. In accordance with Art. 6(2)(a) Financial Services Distance Selling Directive 2002/65/EC, financial services whose price depends on fluctuations in the financial market outside the

supplier's control which may occur during the withdrawal period, are exempted. This may be services related to foreign exchange, money market instruments, transferable securities, units in collective investment undertakings, financial-futures contracts, including equivalent cash-settled instruments, forward interest-rate agreements, swaps, or options to acquire or dispose of any such instruments including equivalent cash-settled instruments, in particular options on currency and interest rates.

Paragraph (2)(h) reflects the exception in Art. 6(2)(b) of the Financial Services Distance Selling Directive 2002/65/EC. Due to the nature of the contract and in order to avoid speculation by the consumer, it is reasonable to exclude short-term insurance policies from the right of withdrawal.

Paragraph (4) is based on Art. 6(2)(c) of the Financial Services Distance Selling Directive 2002/65/EC (cf. with regard to this rule below under H.).

G. In particular: auctions

Paragraph (2)(g) is based on Art. 3(1) 5th indent Distance Selling Directive 1997/7/EC. It is an open question whether this provision of the Distance Selling Directive only refers to traditional auctions (such as a fine art auction in one of the major auction houses, or a racehorse auction) or whether it also applies to internet auctions (such as ebay "auctions"). In the case of traditional auctions it would be entirely impractical if a bidder who participates in the auction via phone could benefit from the right of withdrawal, while bidders who are present at the auction do not have such a right. With regard to internet auctions, in which all bidders participate via means of distance communication, one might argue that there is no such issue of unjustified unequal treatment of present and absent bidders. While the Acquis does not provide a clear answer to the question of how the term "auction" is to be understood, the Member States seem to be moving towards a narrow interpretation of the term and thus towards limiting it to traditional auctions as described above.

H. Particular exemptions for distance contracts (paragraph (3))

Paragraph (3) supplements paragraph (2) with particular exceptions for contracts concluded by the business exclusively by means of distance communication. The term 'means of distance communication' refers to any means which, without the simultaneous physical presence of the supplier and the consumer, may be used for the conclusion of a contract between those parties in accordance with Art. 2(4) sentence 1 Distance Selling Directive 1997/7/EC.

Paragraph (3)(a) is based on Art. 3(2), 2nd indent of the Distance Selling Directive 1997/7/EC. The scope and rationale of this exemption was set out by the ECJ in the case C-336/03 – *EasyCar*. It is aimed at exempting suppliers of services in certain sectors because the requirements of the Directive could affect those suppliers disproportionately. In particular, where the request of a service resulted in a booking and that booking is

cancelled by the consumer at short notice before the date specified for the provision of that service. The ECJ therefore considered that car hire undertakings are transport services for the purposes of this exception. The exception applies when the time of performance was agreed upon at the time of the conclusion of the contract.

Illustration 7

A consumer hires a car through the internet for a specific period. She wants to withdraw from the contract. The consumer does not have a right of withdrawal because these contracts fall under the exception of paragraph (3)(a) of the Article (cf. ECJ, C-336/03 – *EasyCar*).

Paragraph (3)(b) is based on Art. 6(3), 1st indent of the Distance Selling Directive 1997/7/EC. The provision should be read in relation to paragraph (4), which is based on Art. 6(2)(c) of the Financial Services Distance Selling Directive 2002/65/EC. Art. 6(3), 1st indent of the Distance Selling Directive 1997/7/EC provides that the consumer may not exercise the right of withdrawal in respect of contracts for the provision of services if performance has begun, ‘with the consumer’s agreement’, before the end of the withdrawal period. Art. 6(2)(c) of the Financial Services Distance Selling Directive 2002/65/EC states that the right of withdrawal shall not apply to contracts that have been fully performed by both parties ‘at the consumer’s express request’ before the consumer exercises her or his right of withdrawal. Paragraph (3)(b) aligns and clarifies the two provisions. The right of withdrawal will be lost ‘at the consumer’s express and informed request’ for performance. Since the request needs to be informed, the consumer needs to be aware that performance (for distance selling of services other than financial services; full performance for financial services) during the period for withdrawal at her or his request extinguishes the right of withdrawal.

It should be noted that the requirement of an ‘informed’ request also avoids uncertainty (with regard to services other than financial services) about what acts constitute performance for the purposes of this rule (i.e. any small partial performance after the conclusion of the contract, or only performance of the ‘characteristic’ service). A BELGIAN Court held that booking a flight service by a business provider constituted performance. Consequently, the right of withdrawal was extinguished; provision of the flight service during the withdrawal period was not required (Judge of the Peace Ghent (BELGIUM), eerste kanton, 7 April 2003, A.R. 010617 – *Airstop*). The wording of this rule prevents businesses from claiming that a minor act of performance during the withdrawal period extinguishes the right of withdrawal if the consumer was not informed of this consequence.

In the case of paragraph (3)(b), i.e. services other than financial services, performance just by the business before the end of the period for withdrawal extinguishes the right of withdrawal. In the case of financial services, paragraph (4) stipulates that only full performance by both parties before the end of the withdrawal period extinguishes the right of withdrawal. The right of withdrawal is in any case preserved if (other) pre-contractual information which was required has been omitted. In such a case, the withdrawal period is extended under II.–3:107 (Remedies for breach of information duties) paragraph (1) and II.–5:103 (Withdrawal period).

Paragraph (3)(c) is based on Art. 6(3), 3rd indent of the Distance Selling Directive 1997/7/EC. Allowing the consumer the right of withdrawal for these categories of goods would result in significant losses for businesses. If such an exemption were absent, it may well be that businesses would decline to sell these categories of goods through means of distance communication.

Illustration 4

A consumer buys curtains through the internet and specifies length and width. The consumer will not have a right of withdrawal.

Illustration 5

A consumer buys a laptop through the internet and specifies the operating system, memory and hard disk capacity required. The laptop is delivered and the consumer then decides to exercise the right of withdrawal. The exemption of paragraph (3)(c) for goods made to the consumer's specifications does not apply if the goods were made out of standard units and can be disassembled with relatively minor costs and efforts (cf. BGH (GERMAN Supreme Court), judgment of 19 March 2005, VIII ZR 295/01, Neue Juristische Wochenschrift (NJW) 2003, 1665-1667).

Illustration 6

A business sells horticultural products by mail-order. Its catalogue states that consumers do not have a right of withdrawal. Such a statement is too general as not all horticultural products deteriorate rapidly and are therefore exempted from the right of withdrawal under Art. II.-5:201(4)(c) (cf. Hof van Beroep/Cour d'appel Brussels (BELGIUM) 21 January 1999, P. Bakker Hillegom / Ets. Gonthier).

Paragraph (3)(d) is based on Art. 6(3), 4th indent of the Distance Selling Directive 1997/7/EC. The rationale for this exemption is the prevention of possible abuse from the consumer. The exemption is, however, broadened as it also applies to the supply of audio, video and computer software supplied by electronic means if the consumer is in a position to download or reproduce the data. The rationale for this exemption is identical: prevention of possible abuse from the consumer. Such an exemption already exists in several Member States. Illustration 7

A consumer downloads music against payment. It can be copied on any medium. The consumer will not have the right of withdrawal.

Paragraphs (3)(e) and (3)(f) are based on Art. 6(3) 5th indent and Art. 6(3) 6th indent of the Distance Selling Directive 1997/7/EC. Again, these exemptions seek to balance the interests of businesses and consumers. Allowing the right of withdrawal for these goods could lead to substantial losses by businesses and possible abuse from consumers in the case of gaming and lottery services.

Illustration 8

A consumer buys a lottery ticket using the internet. The contract is not subject to the right of withdrawal because the exemption in paragraph (3)(f) applies.

I. No exception for expressly requested business visits

In contrast to Art. 1(1) 2nd indent of the Doorstep Selling Directive 1985/577/EEC, the present Article does not stipulate for an exception from the right to withdraw from contracts concluded in a doorstep situation where the consumer had expressly requested the visit. This follows a tendency visible in several Member States. Consumers may be subject to high pressure selling even when they requested the business visit themselves. Thus, consumers enjoy protection in doorstep cases irrespective whether the visit was unsolicited or solicited.

J. No exemption for low value contracts

The present Article does not contain an exemption for low value contracts as can be found in Art. 3(1) sentence 1 of the Doorstep Selling Directive 1985/577/EEC. Although it can be argued that consumers who conclude low value contracts need less protection than in cases where high value goods are marketed, nearly half of the Member States have not transposed this exemption. The others stipulate for such an exemption, whereby the threshold varies between 10 and 50 Euro. Contracts with a price up to that amount concluded in a doorstep situation cannot be withdrawn in these States. However, it might be confusing for consumers that there is a withdrawal right only for contracts of a value above the threshold. The consumer might expect that such a threshold, if he or she actually happens to know about it, is much lower than 40 or 50 Euros. Businesses will not be burdened very much by the lack of such exemption for low value contracts, as consumers may not have a great interest to withdraw if the price of the goods was low. Moreover, it would not be appropriate to extend this option to distance selling contracts anyway, as in such cases the impossibility to inspect the goods and to verify their quality deprives the consumer of the information needed to make an informed choice. For these reasons a uniform rule for all contracts which fall under the present Article seemed preferable.

II.-5:202: Timeshare contracts

(1) A consumer who acquires a right to use immovable property under a timeshare contract with a business is entitled to withdraw from the contract.

(2) Where a consumer exercises the right of withdrawal under paragraph (1), the contract may require the consumer to reimburse those expenses which:

- (a) have been incurred as a result of the conclusion of and withdrawal from the contract;*
- (b) correspond to legal formalities which must be completed before the end of the period referred to in II.-5:103 (Withdrawal period) paragraph (1);*
- (c) are reasonable and appropriate;*
- (d) are expressly mentioned in the contract, and*
- (e) are in conformity with any applicable rules on such expenses.*

The consumer is not obliged to reimburse any expenses when exercising the right of withdrawal in the situation covered by paragraph (1) of II.–3:107 (Remedies for breach of information duties).

(3) The business must not demand or accept any advance payment by the consumer during the period in which the latter may exercise the right of withdrawal.

COMMENTS

A. Purpose and structure

The present Article, which grants consumers the right of withdrawal for timeshare contracts, is based on the provisions of the Timeshare Directive 1994/47/EC, in particular Art. 5 and 6 and Recitals 11 to 14. For timeshare contracts, the complex provisions of the contract create a structural imbalance between the parties. The cooling off period gives the purchaser the chance to understand better what the obligations and rights under the contract are (Recital 11 of the Timeshare Directive 1994/47/EC). Timeshare contracts are, moreover, often concluded abroad and may be governed by foreign laws (Recital 11 of the Timeshare Directive 1994/47/EC). Extra time may therefore be required to consult a local lawyer to understand the content of the contract. In addition, timeshare contracts are sometimes sold through aggressive sales practices. A cooling off period allows the purchaser to assess the merit of the contract without being subject to any external pressure. Finally, personal preferences during a holiday may vary from preferences in everyday life. A cooling off period allows consumers to reconsider their decision in the light of more usual conditions.

Paragraph (1) sets out the objective situation in which the consumer has the right of withdrawal. Paragraph (2) limits the costs of legal formalities that the consumer may be required to defray in case of withdrawal. This paragraph balances the need not to unduly hamper the conclusion of timeshare contracts with the need to ensure that the costs related to legal formalities imposed on the consumer do not deter her or his exercise of the right of withdrawal. Paragraph (3) intends to enhance the efficiency of the right of withdrawal. It prohibits the demand or acceptance of advance payments during the withdrawal period for these contracts. The prohibition protects the consumer against the risk of being deterred from exercising the right of withdrawal because of the uncertainty of whether these payments can be easily recovered.

B. Definition of timeshare contracts

The wording of paragraph (1) (a right which allows him or her to use immovable property under a timeshare contract) is deliberately chosen to cover a wide variety of situations. Thus this provision applies irrespective of the particular contractual construction chosen by the parties, be it the transfer of a real property right or any other right relating to the use of the timeshare property (cf. Art. 2, 1st indent Timeshare Directive 1994/47/EC). Furthermore, the provision also applies to binding preliminary contracts.

However, for a future revision of these rules extending the right of withdrawal might have to be considered. According to the recent Proposal for a revision of the Timeshare Directive (COM (2007) 303) the definition of timeshare would no longer exclusively be linked to immovable property. Thus, contracts for accommodation in canal boats, caravans or cruise-ships would also be covered. In addition, the right of withdrawal would also be granted for timeshare-like products, e.g. discount holiday clubs (so-called “long term holiday products”, cf. Art. 2 (1) (b) of the Proposal). Yet, for the time being, the present Article reflects the current *acquis communautaire* as stated in the existing Timeshare Directive 1994/47/EC. Also the majority of Member States did not go beyond this scope.

C. Length and beginning of withdrawal period

The withdrawal period granted in these rules is fourteen days. Under Art. 5(1) 1st indent Timeshare Directive 1994/47/EC the consumer has ten days from the signing of the contract to exercise the right of withdrawal. In contrast to this, the length of the withdrawal period for timeshare contracts has been harmonised. Thus, the general rule of II.–5:103 (Withdrawal period) now also governs timeshare contracts to which, therefore, the uniform regular period applies.

One may, however, consider an even longer period to allow withdrawal from timeshare contracts. A period of fourteen days will not always ensure that consumers can reflect on their decision once at home. In this period the consumer may still be on holiday or abroad. A period of one or several months may be more adequate. In addition, fourteen days may not be sufficient for a consumer to obtain the advice that is needed to make a well-considered decision. Finally, one may want to consider if the withdrawal period should run from the day of the first inspection of the property, or possibility to use the property (similar to distance selling cases, cf. Art. II.–5:103(1) sent. 2). This would better ensure that the consumer is fully aware of the exact scope and object of the timeshare contract. However, the *acquis communautaire* presently does not provide sufficient basis for such a prolongation of the withdrawal period. Also the laws of the Member States currently do not provide a longer withdrawal period. In addition, the approach followed by these rules is in line with the Proposal for the revision of the Timeshare Directive, which also provides for a fourteen day withdrawal period (cf. Art. 5(1) of the Draft, COM (2007) 303).

The withdrawal period starts in accordance with the general rule in II.–5:103 (Withdrawal period). Therefore the date of the conclusion of the contract and the notice of the right of withdrawal are decisive. In general, the period starts after the conclusion of the contract and after the consumer has received notice of the right of withdrawal in textual form on a durable medium in accordance with II.–5:104 (Adequate notification of the right to withdraw). This approach brings the computation of the withdrawal period for timeshare contracts in line with other withdrawal rights in these rules and abandons the deviating solution provided for in Art. 5(1) 1st indent Timeshare Directive 1994/47/EC

according to which the withdrawal period starts from the signing of the contract or the signing of a binding preliminary contract.

When determining the beginning of the withdrawal period, consideration must also be given to the fulfilment of the pre-contractual information duty under II.–3:103 (Duty to provide information when concluding a contract with a consumer who is at a particular disadvantage). According to II.–3:107 (Remedies for breach of information duties) paragraph (1) the withdrawal period does not commence until the information required under II.–3:103 (Duty to provide information when concluding a contract with a consumer who is at a particular disadvantage) has been provided. However, even in such a case the right of withdrawal lapses at the latest after one year from the time of the conclusion of the contract. The present Article thus abandons the complicated rules introduced by Art. 5(1) 2nd and 3rd indent of the Timeshare Directive 1994/47/EC that prolong the withdrawal period in cases where the required information was omitted. The information duty under II.–3:103 (Duty to provide information when concluding a contract with a consumer who is at a particular disadvantage) and the corresponding remedy for its violation provided in II.–3:107 (Remedies for breach of information duties) paragraph (1), offer a satisfactory and consistent solution on the point. Moreover, the consumer is better protected by these general rules as they prolong the withdrawal period to up to one year. According to Art. 5(1) 2nd and 3rd Timeshare Directive 1994/47/EC the withdrawal period is prolonged only up to a maximum of three months and ten days.

D. Reimbursement of expenses

Paragraph (2) rephrases Art. 5(3) and (4) of the Timeshare Directive 1994/47/EC. The expenses that the consumer may be required to defray include the costs of notarisation and attestation of the contract and the duties and taxes charged for it. Such expenses must be expressly mentioned in the contract. Consequently, the same formal requirements that apply to timeshare contracts in general also apply to the information about expenses. The requirements laid down in paragraph (2)(a) to (2)(e) are therefore cumulative and not alternative. Art. 5(4) of the Timeshare Directive 1994/47/EC provides that the purchaser may not be required to defray certain expenses when the right of withdrawal is exercised during the prolonged period for withdrawal. The last sentence of paragraph (2) reaches the same outcome.

Illustration 1

A consumer concludes a timeshare contract but then withdraws from it. The other party is entitled to the costs of notarisation and attestation of the contract, as well as to the pertinent duties and taxes, provided that the expenses are reasonable and appropriate (paragraph (2)(c)), if they are expressly mentioned in the contract (paragraph (2)(d)) and conform to any applicable rules on such expenses (paragraph (2)(e)).

E. Prohibition of advance payments

Paragraph (3), which is based on Art. 6 Timeshare Directive 1994/47/EC, prohibits the demand or acceptance of any advance payment by the consumer while the withdrawal period is running. This prohibition enhances the effectiveness of the right of withdrawal. With regard to Art. 6 of the Timeshare Directive 1994/47/EC, it is debated whether the prohibition on advance payments should only apply during the initial ten day withdrawal period, or also during the prolonged withdrawal period. Since the withdrawal period is prolonged because the business failed to provide certain information, it is preferable to hold that such prohibition should be extended accordingly. Thus, the prohibition established by paragraph (3) of the present Article should be interpreted accordingly. This interpretation is in line with the Proposal for a revision of the Timeshare Directive (COM (2007) 303), which contains a clarification on this issue. In addition, the prohibition of advance “payments” also prohibits the provision of guarantees, reservation of money on a credit card, explicit acknowledgement of debt or any other consideration to the business (cf. Draft Art. 6(1) from the Proposal, COM (2007) 303).

Illustration 2

A consumer signs a timeshare contract. The price is only due when the withdrawal period is over. The deposit by the consumer of a sum as a guarantee for the payment of the deferred price is also prohibited under paragraph (3) (cf. Audiencia Provincial Las Palmas (SPAIN) 22 November 2003, 682/2003 *Benedicto and Margarita v Palm Oasis Maspalomas S.L.*).

Illustration 3

A consumer signs a timeshare contract but does not receive the information required. This prolongs the withdrawal period according to II.–3:107 (Remedies for breach of information duties) paragraph (1). The prohibition on demanding or accepting advance payments under paragraph (3) of the present Article also applies during the prolonged withdrawal period. (cf. Audiencia Provincial Cantabria (SPAIN) 24 May 2004, 196/2004 *Sergio and Carmela v “Free Enterprise S. L.*).

Illustration 4

The prohibition on demanding or accepting payments is also infringed when a consumer is required to pay advance money in trust to a lawyer during the withdrawal period (cf. Fővárosi Ítéltábla (Court of Appeal, HUNGARY), 1 December 2004, 2. Kf.27.379/2003/3, *Holiday Club Hungary Kft, Proinvest 2001 Kft vs. Wirtschaftswettbewerbsamt (GVH)*).

Illustration 5

The prohibition on demanding or accepting payments is also infringed when the business accepts a cheque during the withdrawal period, even if it did not explicitly request it and even if it was not cashed during the withdrawal period (cf. Cour de Cassation (FRENCH Supreme Court), 1^{re} chamber, 22 November 1994, 1995, *somm.*, 311).

CHAPTER 6: REPRESENTATION

II.–6:101: Scope

(1) This Chapter applies to the external relationships created by acts of representation – that is to say, the relationships between:

- (a) the principal and the third party; and*
- (b) the representative and the third party.*

(2) It applies also to situations where a person purports to be a representative without actually being a representative.

(3) It does not apply to the internal relationship between the representative and the principal.

COMMENTS

A. General

This chapter deals mainly with the effect of an act done by a representative, or a person purporting to be a representative, on the legal position of the principal or purported principal in relation to the third party. However, some Articles deal with the effect of an act of representation or purported representation on the legal position of the representative or purported representative in relation to a third party.

In general the Articles of this Chapter reflect the principles that are to be found in the large majority of laws of the Member States, even if the ways of expressing these principles differ from law to law. Where the Chapter adopts an approach that is not known in all the laws (for example, some do not apply the same rules to representation where the authority is granted by a contract or other juridical act and where it is given by law (see II.–6:103 (Authorisation)), this will be noted.

B. Restrictions on scope

The general restrictions on the intended scope of the model rules apply to this Chapter. So the rules on the authority of representatives in this Chapter are not intended to be used, or used without modification or supplementation, in relation to (1) representatives appointed by public or judicial authorities to perform public law functions (2) those, such as parents, tutors or guardians, acting as the legal representatives of children or of adults with incapacity (3) executors of deceased persons. (See I.–1:101 (Intended field of application) paragraph (2).) Another important restriction in that paragraph relates to “the creation, capacity, internal organisation, regulation or dissolution of companies and other bodies corporate or unincorporate”. It follows from this that the authority of directors and other company officers in the internal affairs of a company are not intended to be covered by the present Chapter. However, the authority of representatives of a company in dealings with the outside world is intended to be covered and it is important that it should

be covered because this is one of the most important practical applications of the rules on the authority of representatives. Companies can engage in juridical acts only through representatives.

C. Internal relationship not covered

The chapter does not govern the internal relationship between the principal and the representative. That is governed by later Books.

D. Application of general rules on contracts and other juridical acts

The Chapter does not deal with the way in which a principal may grant authority. That will be by a contract or unilateral juridical act, very often the latter. The general rules on contracts and other juridical acts apply, including the rules on formation, interpretation and grounds of invalidity. The general rules are also relevant in relation to contracts concluded, or acts done, by the representative on behalf of the principal.

II.-6:102: Definitions

(1) A “representative” is a person who has authority to affect the legal position of another person, the principal, in relation to a third party by acting on behalf of the principal.

(2) The “authority” of a representative is the power to affect the principal’s legal position.

(3) The “authorisation” of the representative is the granting or maintaining of the authority.

(4) “Acting without authority” includes acting beyond the scope of the authority granted.

(5) A “third party”, in this Chapter, includes the representative who, when acting for the principal, also acts in a personal capacity as the other party to the transaction.

COMMENTS

The term “representative” is used rather than “agent” in order to focus more sharply on the situation where one person represents the other in legal transactions or the doing of juridical acts. No term is ideal because ordinary language is rather loose. It is common for the word “agent” to be used of people who have no authority to affect the principal’s legal position. A detective agent, for example, might be employed to make enquiries about something or locate a missing person but might have no power to conclude contracts or do other juridical acts on behalf of the principal. An estate agent might be authorised to search for a suitable property but might have no authority to make an offer for it on behalf of the principal. It is true that the word “representative” is also often used in ordinary language to refer to those who speak for others but do not have power to affect their legal relations. However, “representative” seems closer to the desired meaning than “agent”. The important point is that the term used has to be defined so that it is clear what it means in the present context. This is the purpose of paragraph (1).

So far as the definition is concerned a choice has to be made between defining a “representative” as a person who actually is authorised to affect the legal relations of another person (the principal) and defining a “representative” as a person who is or purports to be so authorised. The first alternative looks at the position from the point of view of the principal: the second more from the point of view of the third party. Either definition can be made to work but the choice affects the drafting of subsequent Articles. One slight advantage of including the person who purports to be authorised is that this makes it easier to talk later of representatives acting without authority. On the other hand using the word “representative” to cover a person who does not have authority would have the consequence that “authorised representative” would frequently have to be used elsewhere in the text if the intention was to cover only those who could directly affect the principal’s legal position. This latter consideration seems more important than a slight drafting convenience in the present Chapter. So “representative” is defined here as a person who has authority to affect the legal position of another person (the principal) in relation to a third party. II.–6:103 (Authorisation) makes it clear that the authority need not be derived from an express or tacit grant of authority by the principal. It may also be conferred by law.

The definition of “representative” is functional and applies whatever name is given to the representative.

The words “affect the legal position of the principal” are used rather than some shorter expression such as “bind the principal” because the word “bind” might be thought to refer only to the process of creating an obligation for the principal. The representative’s acts may, however, acquire a right for the principal or liberate the principal from an obligation or simply fulfil a requirement which the principal has to fulfil before taking some other legal step. The representative’s act may be, for example, the giving or receipt on behalf of the principal of a notice which has a legal effect. The general effect of representation is that the act of the representative is attributed to the principal as if done by the principal and therefore affects the principal’s legal position just as an act by the principal in person would have done.

Paragraphs (2) and (3) deal with the distinction between the “authority” of the representative (that is to say, the power to affect the principal’s legal position by means of a juridical act) and the “authorisation” of the representative (that is to say, the granting of the authority or the process by which the representative obtains and continues to have authority).

Paragraph (4) is probably not necessary because in relation to any particular juridical act a person acting as a representative will either have authority to do it or will not. One situation where the person will not have authority is where the act is beyond the scope of the authority granted by the principal or the law. However, the paragraph may help to remove any doubts or hesitations on this point.

Paragraph (5) is necessary because there are occasions when a representative acting for the principal contracts with himself or herself acting in a personal capacity and there is a need for rules to cover that situation. There may also be cases where the representative, acting for the principal, concludes a contract with himself or herself acting as representative for another principal. However, no special provision is needed for this second type of case because the second principal is already in law the third party.

II.–6:103: Authorisation

(1) The authority of a representative may be granted by the principal or by the law.

(2) The principal's authorisation may be express or implied.

(3) If a person causes a third party reasonably and in good faith to believe that the person has authorised a representative to perform certain acts, the person is treated as a principal who has so authorised the apparent representative.

COMMENTS

A. How representative can obtain authority

This Article sets out the ways in which a representative may obtain authority. Essentially authority may be derived from the principal or from the law.

B. Express or implied grant of authority by principal

A representative's authority may be granted by the principal expressly or impliedly.

In giving express authority to the representative, no particular form needs to be observed. It is important that this should be the general rule because in ordinary life there are many informal situations where, for example, one private individual asks another to buy something for him or her or to conclude on his or her behalf some service contract such as one for the dry cleaning of clothes or the development of photographs. In more formal situations, however, a written grant of authority will almost invariably be regarded as essential for the protection of all the parties involved. Frequently, but not necessarily, the authorisation of the representative will be communicated by the principal to others.

Express authority may be granted by using, or making reference to, a standard form listing the powers of representative of a certain type. The use of such standard forms has many advantages for all the parties involved. The Conférence des Notariats de l'Union Européenne (CNUE) has published a collection of such standard forms for different situations and plans to publish a new collection.

In many situations there is no express grant of authority but the principal intends the representative to have authority and impliedly grants it, often by placing an employee in a

position where the granting of authority must be implied from the circumstances. This way of granting authority plays an important role in practice.

Illustration 1

A store which employs a salesperson in its sales department impliedly authorises that person to transact any business relating to the merchandise offered for sale and to bind the shop by any such transaction.

An implied authority may well be subject to express limitations by the principal; such express limitations may even indicate the authority which is otherwise implied.

Usages and practices are often very important in deciding whether a principal has impliedly granted authority to a representative. The appointment of a person as an agent of a certain type may by usage, or by practices established between the parties, confer on that agent authority to act as the principal's representative in relation to certain types of legal transaction.

C. Authority granted by law

The representative may derive authority from a rule of law. For example, directors of a company may have authority by law to bind the company or otherwise affect its legal relations. Partners may have a similar authority to act as representatives of the partnership. National laws frequently grant powers of representation to persons in certain positions or situations. Some of the rules of this Chapter can themselves be regarded as conferring authority even if they do not always do so in so many words. For example, paragraph (3) of this Article in effect confers authority based on the appearance of things. The Article on ratification by the principal in effect confers authority retrospectively once ratification occurs. The Article on the effect of termination of authorisation confers authority by law to do certain things even after the principal has recalled the representative's authorisation.

It is important that the rules of this Chapter should apply to representatives who are granted their authority by a rule of law (provided the situations are within the intended scope of the model rules). In these cases the law (e.g. a Company Law) often merely deals with the grant of authority for the legal representatives of the company, but impliedly leaves the consequences of the exercise of the authority to the general rules on representation. This gap can and should be filled by the general rules of this Chapter on representation except in so far as the respective law contains specific restrictions or other qualifications.

D. “Apparent” authority

A representative's authority is not necessarily based on statements or acts by which the principal intended to grant authority. Even without the principal's express or implied intention, a representative's authority may come into being by law if the principal has induced a third party reasonably and in good faith to believe that the representative has been granted authority to represent the principal. This type of authority is called, perhaps

slightly misleadingly, “apparent” authority because it is authority based on the appearance of things.

A representative who has this type of authority will have power to bind the principal as much as if the principal had expressly granted the representative authority. This rule is designed to protect the third party who has relied, reasonably and in good faith, upon the impression that the principal had in fact granted authority.

On the other hand, the possibly countervailing interest of the principal not to be bound by the representative’s act also deserves to be taken into account. Paragraph (3) balances these two interests by requiring that the person who is treated as a principal must have caused the third party reasonably and in good faith to believe that the person had granted the representative authority to perform the relevant acts.

A specific situation in which an apparent authority may arise is the case where authorisation is recalled by the principal but this is not made known to third parties. Because of its importance, this situation is specifically regulated by a later Article (II.–6:112 (Effect of ending or restriction of authorisation)).

It will be noted that paragraph (3) goes further than saying that the principal is precluded from invoking against the third party the representative’s lack of authority. The representative actually has authority no matter who invokes the fact that there was no express or implied grant of authority by the principal.

The provision in paragraph (3) may be supplemented by provisions of national or European law dealing with particular situations. For example Article 8 of the First Company Directive 68/151/EEC provides that completion of the formalities of disclosure of the particulars concerning the persons who, as an organ of the company, are authorised to represent it shall constitute a bar to any irregularity in their appointment being relied upon as against third parties unless the company proves that such third parties had knowledge thereof. See also EC Directive 89/666/EEC.

II.–6:104: Scope of authority

(1) The scope of the representative’s authority is determined by the grant.

(2) The representative has authority to perform all incidental acts necessary to achieve the purposes for which the authority was granted.

(3) A representative has authority to delegate authority to another person (the delegate) to do acts on behalf of the principal which it is not reasonable to expect the representative to do personally. The rules of this Chapter apply to acts done by the delegate.

COMMENTS

A. Scope of authority depends on terms of grant

The scope of a representative's authority depends primarily on the terms in which it is granted or conferred. This is confirmed by paragraph (1). In several Member States commercial law statutes provide standardised forms of authority defining exactly the contents and limits of the powers conferred if, for example, an employer decides to grant authority to employees in a certain category.

B. Authority to do incidental acts

Paragraph (2) applies only where the grant of authority, or the circumstances of the case, do not indicate the contrary. It deals with one limited matter - namely, the representative's authority to do incidental acts which are necessary to achieve the purposes for which the authority was granted. In the absence of such a provision express grants of authority might have to be excessively detailed so as to cover every possible incidental act which the representative might have to do. Such careful provision may be expected in legally drafted grants of authority but cannot reasonably be expected of informal grants of authority by lay persons acting without legal advice.

C. Delegation of authority

Frequently, a representative cannot reasonably be expected to perform personally the acts or all the acts required and may wish to involve other persons. This may occur, in particular, because of distance from the place where the necessary acts have to be performed or because of the representative's lack of specific competence. In these cases, it may be reasonable for the representative to delegate authority to do the acts, and although not all the laws permit delegation (or do so only in certain cases), this Chapter provides for it.

Delegation of authority must be distinguished from delegation of performance – where a debtor consents to the obligation being performed by someone else. Delegation of authority relates not to the performance of an obligation but to the actual doing of a juridical act for the principal

The representative may have express authority to delegate. Indeed it is to be recommended that the principal clarify expressly whether or not the representative is so authorised. In order to clarify a situation where the principal has failed to do so, paragraph (3) establishes a default rule which will apply unless otherwise provided in the grant or indicated by the circumstances.

Illustration

An old lady P living in a small European town has given a general power to her representative A living in the same town. She directs A to invest a substantial sum of money by acquiring an apartment house in New York. A has power under this

Article to appoint a qualified person in New York to do the necessary juridical acts.

The person to whom the authority is delegated (“the delegate”) acts on behalf of the principal. All the provisions of this chapter apply to the acts done by that person. This rule is laid down by the second sentence of paragraph (3).

The delegate’s authority is derived directly from the representative and only indirectly from the principal. The representative cannot delegate more authority than the representative already has. It follows that, for the delegate to effect the same consequences that are achieved by the acts of the representative, the acts of the delegate must be within both the delegated authority and that of the representative. If the acts of the delegate are to affect the legal position of the principal directly it is also necessary that the delegate should act in the name of the principal or otherwise in such a way as to indicate an intention to affect directly the legal position of the principal.

Under these conditions the acts of the delegate have the same effects as if these acts had been done by the representative. They bind the principal and the third party directly, while the representative is not bound.

The appointment of a delegate must be distinguished from the replacement of the original representative by a new representative. The new representative assumes (usually) the same position as the predecessor. The acts of the new representative are fully subject to the rules of this chapter; no special rule is required to express this idea.

II.–6:105: When representative’s act affects principal’s legal position

When the representative acts:

(a) in the name of a principal or otherwise in such a way as to indicate to the third party an intention to affect the legal position of a principal; and
(b) within the scope of the representative’s authority,
the act affects the legal position of the principal in relation to the third party as if it had been done by the principal. It does not as such give rise to any legal relation between the representative and the third party.

COMMENTS

A. Basic effect of representation

This Article deals with the normal basic effects of a juridical act by a representative. The rule is that where the representative has acted openly as such (i.e. in the name of the principal or otherwise in such a way as to indicate an intention to affect directly the legal position of the principal) and has acted with authority, the representative’s act directly affects the legal relationship between the principal and the third party but does not give

rise to any legal relation between the representative and the third party. In other cases, the basic rule is that the principal's legal relations are not directly affected by the representative's act. The consequences for the representative are dealt with in succeeding Articles.

B. Representative must act as such if principal is to be affected

The act of the representative will bind the principal or otherwise affect the principal's legal relations only if the representative acts in the name of the principal or otherwise in such a way as to indicate to the third party an intention to directly affect the legal relations of a principal. It is not necessary that the representative should say "In the name of ..." or use any other special form of words. Indeed the name of the principal need not even be mentioned. However, if the representative wishes to avoid personal liability it will be important to make it clear by one means or another that the act in question is being done in a representative capacity.

If paragraph (1)(a) of the Article is complied with, the third party will know, or at least could reasonably be expected to know, that the representative is acting as a representative of a principal and not in a personal capacity.

C. Representative must have authority if principal is to be affected

The act of the representative will bind the principal or otherwise affect the principal's legal position only if it is done with authority. As we have seen, the representative (or the person purporting to be a representative) will not have authority to do the act either if there is no authority at all or if the particular act is beyond the representative's authority.

D. Special situations

The Article deals with the basic and normal position. Of course, the representative and the third party or the principal and the representative may by agreement depart from the normal rules and impose personal liability upon the representative. The representative may become a co-debtor or a guarantor of the principal's obligations. The following Article establishes another exception.

II.-6:106: Representative acting in own name

When the representative, despite having authority, does an act in the representative's own name or otherwise in such a way as not to indicate to the third party an intention to affect the legal position of a principal, the act affects the legal position of the representative in relation to the third party as if done by the representative in a personal capacity. It does not as such affect the legal position of the principal in relation to the third party unless this is specifically provided for by any rule of law.

COMMENTS

If the representative acts in his or her own name or otherwise in such a way as not to indicate to the third party an intention to affect directly the legal relations of a principal, then the representative will be regarded as acting in a personal capacity and the act, if it is valid, will establish direct legal relations between the representative and the third party. The Act will not directly affect the legal position of the principal in relation to the third party unless this is specifically provided for by a special rule of law for a particular situation. For example, there may be cases where it would be safe and appropriate for a special rule to provide for the ownership of property bought by the representative for a hidden principal to pass directly to the principal, or at least to do so in certain clearly identified circumstances.

It is important to note that the representative may be personally bound even if the existence of a principal is disclosed to the third party. Everything depends on whether the representative acts in such a way as to indicate to the third party an intention to affect directly the legal relations of a principal. A representative may, for example, say "I am instructed and authorised to buy this item for a collector who prefers to remain anonymous. However, any contract for its purchase will be concluded by me in a personal capacity and will not directly affect my principal." In such a case the third party must decide whether to accept the risk of contracting only with the representative. In the absence of any special rule on the question of passing of ownership in such a situation the manner in which, and terms on which, the item acquired by the representative would be passed on to the principal would be regulated by the contract between the representative and the principal.

II.-6:107: Person purporting to act as representative but not having authority

(1) When a person acts in the name of a principal or otherwise in such a way as to indicate to the third party an intention to affect the legal position of a principal but acts without authority, the act does not affect the legal position of the purported principal or, save as provided in paragraph (2), give rise to legal relations between the unauthorised person and the third party.

(2) Failing ratification by the purported principal, the person is liable to pay the third party such damages as will place the third party in the same position as if the person had acted with authority.

(3) Paragraph (2) does not apply if the third party knew or could reasonably be expected to have known of the lack of authority.

COMMENTS

A. Consequence of lack of authority

This Article deals with the consequences which follow if a person purporting to act for a principal does an act without authority. It does not matter whether the person is a representative who is acting beyond authority or a person who has no authority at all. The basic rule is that the act does not bind the purported principal or otherwise affect the legal relations between the purported principal and the third party. The act does not directly bind the person acting as a representative either. The third party has no reason to suppose that that person is acting in a personal capacity and no reason to rely on that person's credit or reputation. The third party intends to transact with the supposed principal, not the purported representative. The person purporting to act as a representative with authority may, however, be liable in damages to the third party. (See paragraph (2)).

There may be ratification by the purported principal. When that occurs the act of the representative will affect the principal's legal relations but only as a result of the ratification and not as a result of the act itself.

B. Partial lack of authority

Where an existing authority of a representative covers an act in part only, the effect of such partial lack of authority depends upon whether the legal relationship or effect involved is divisible or indivisible. In the latter case, the principal is not bound at all. In the former case, the authorised part of the act will bind the principal and the third party but not the unauthorised part.

Illustration

If a representative has power to overdraw the principal's account to an amount of €10,000 and overdraws €11,000, the principal is bound to repay €10,000 only.

C. Liability for damages

By acting in a principal's name or otherwise in such a way as to indicate an intention to affect a principal's legal relations, a person can be regarded as warranting to the third party that there is authority to do so. If the person does not in fact have this authority, this does not mean that the person is bound by the contract or act; but only that there is an obligation to pay damages to the third party. The compensation must put the third party into the same position as if the person had acted with authority. If the person proves that the principal could not have performed the contract, nor have paid compensation (for instance because the principal is insolvent) the person need not even pay damages.

D. Effect of ratification or third party's knowledge

The person is not liable under paragraph (2) if the purported principal ratifies the act. There is no need for liability in such a case and no justification for it. Nor is the person liable if the third party knew or could reasonably be expected to have known of the lack of authority. In such a case the third party must be regarded as having taken the risk that

the supposed representative had no authority or that the purported principal would not ratify.

II.–6:108: Unidentified principal

If a representative acts for a principal whose identity is to be revealed later, but fails to reveal that identity within a reasonable time after a request by the third party, the representative is treated as having acted in a personal capacity.

COMMENTS

A. Unidentified principal

The act of a representative may affect the principal's legal position and not the representative's even if the representative, although acting expressly for "a" principal, does not at first reveal the principal's identity. But such secrecy cannot be continued forever if the third party demands to be told the principal's identity.

B. Representative failing to identify principal

If the third party has asked for identification of the principal and the representative fails or refuses to reveal that identity (possibly on the principal's instruction), the representative becomes personally bound to the third party. This rule, which is not found in all the laws, is justified because the representative assumed that risk by refusing to reveal the principal's identity.

Binding the representative to the third party is also justified by the fact that the representative usually will be able to transfer to the principal any assets received from the third party, and conversely the principal will usually reimburse the representative for the charges incurred vis-à-vis the third party. This distinguishes the cases covered by this Article from those in which the representative acts without authority where by virtue of the warranty of authority the representative is merely obliged to pay damages to the third party.

II.–6:109: Conflict of interest

(1) If an act done by a representative involves the representative in a conflict of interest of which the third party knew or could reasonably be expected to have known, the principal may avoid the act according to the provisions of II.–7:209 (Notice of avoidance) to II.–7:213 (Partial avoidance).

(2) There is presumed to be a conflict of interest where:

- (a) the representative also acted as representative for the third party; or*
- (b) the transaction was with the representative in a personal capacity.*

(3) However, the principal may not avoid the act:

- (a) if the representative acted with the principal's prior consent; or*
- (b) if the representative had disclosed the conflict of interest to the principal and the principal did not object within a reasonable time; or*
- (c) if the principal otherwise knew, or could reasonably be expected to have known, of the representative's involvement in the conflict of interest and did not object within a reasonable time.*

COMMENTS

A. The basic issue

In the triangular situation of representation, the representative is exposed to the usually diverging interests of three persons. While being obliged to promote and preserve the principal's interests, the representative may be approached by the third party who is seeking to pursue other interests. In addition, the representative may be tempted to pursue the representative's own interests at the expense of the principal. The situation creates so much danger for the principal that, although not all the laws currently provide a solution, or do so only in some cases, it is important to provide the principal with an appropriate remedy.

B. Relevant conflict of interests

Sanctions affecting a contract concluded by the representative or other act done by the representative can be imposed only if this is equitable in relation to the parties to the transaction.

The principal's interests in this respect are protected by allowing the principal to decide whether or not to avoid the act.

The third party's interest in preserving the act is protected by the requirement that the third party knew or could reasonably be expected to have known of the conflict of interests.

C. Consequences of a relevant conflict of interests

Paragraph (1) provides that the principal may avoid the act if the representative had concluded it in spite of a relevant conflict of interests.

D. Special cases

Paragraph (2) deals with two specific instances of a potential conflict of interests. A conflict may arise if the representative for principal A acts at the same time as representative for principal B and as such a dual representative concludes a transaction. Since in this situation the representative must take care of the potentially opposite interests of two persons, a risk of neglecting the interests of one of the two principals is often present.

The same duality and therefore potential conflict of interests exists if the transaction is between the representative, acting as representative, and the representative in a personal capacity, i.e. if the representative is also the “third party” in relation to the principal.

In these two situations, a material conflict of interests is presumed to exist. This presumption of a conflict of interests is, however, rebuttable.

Illustration

Representative A is instructed by the principal to buy 50 shares of X Corp. at the current market price. Since A wishes to dispose of A’s own holding of shares in X Corp., A sells these shares to the principal for the current market price. The latter fact neutralises the conflict of interests.

E. Consequences of a conflict of interests

Where a representative in concluding a transaction acts for both contracting parties or with himself or herself, the act can be avoided by the principal, unless one of the justifications enumerated in paragraph (3) applies. In the case dealt with in sub-paragraph (a) of paragraph (2), where the representative also acts as representative for the third party, each of the two principals is entitled to avoid the act.

F. Exceptions

Customs and national legislation may give certain types of representatives the option of dealing with themselves under certain conditions.

G. Avoidance excluded

The third paragraph lays down three instances in which avoidance of the act is excluded. The first - prior consent of the principal - is self-evident. The second and third - disclosure of the conflict of interests by the representative, or knowledge or constructive knowledge of it by the principal - require a brief explanation. The disclosure, or actual or constructive knowledge, must occur in advance of the representative’s act so that the principal is in a position to prevent the representative from acting. Disclosure or actual or constructive knowledge suffices to bar avoidance, unless the principal concerned objects within a reasonable time.

Where there are two principals (in the situation covered by paragraph (2) (a)), and only one has the knowledge, as a result of disclosure or otherwise, only that one is barred from avoiding the act.

In addition to the three instances regulated in paragraph (3), avoidance is also excluded if the principal (or both principals, where applicable) have confirmed the act expressly or impliedly after learning of the ground for avoidance. This follows from the general rules on the avoidance of contracts and other juridical acts which are covered in later Articles.

II.-6:110: Several representatives

Where several representatives have authority to act for the same principal, each of them may act separately.

COMMENTS

It is common in practice for principals to grant authority to two or more representatives. The same result may follow in situations where authority is conferred by law. The purpose may be to spread the workload or simply to ensure that if one representative is unable to act the other will be able to do so. In some cases the double appointment may be seen as a safeguard against abuse, both representatives being required to act together before the principal will be bound. In this situation, their authority is said to be joint. It is necessary to have a default rule for this situation.

The default rule chosen here is that each representative may act separately unless otherwise provided. The reason for choosing this as the default rule is that it leads to greater freedom of action. A requirement of joint action could be restrictive in many situations. A principal who wishes to require joint action as a safeguard against abuse can easily do so.

II.-6:111: Ratification

(1) Where a person purports to act as a representative but acts without authority, the purported principal may ratify the act.

(2) Upon ratification, the act is considered as having been done with authority, without prejudice to the rights of other persons.

(3) The third party who knows that an act was done without authority may by notice to the purported principal specify a reasonable period of time for ratification. If the act is not ratified within that period ratification is no longer possible.

COMMENTS

A. The principle of ratification

The first paragraph establishes the general principle that, by ratification, a purported principal may cure any lack of authority on the part of a person who has purported to act as his or her representative.

Ratification may be made by express declaration addressed to the representative or the third party. Ratification may also be implied from acts of the purported principal which unambiguously demonstrate an intention to adopt the contract made or act done.

Illustration 1

In the name of a principal P, who is a merchant, representative A has contracted with T, also a merchant, for the purchase of the most recent model of a computer for €2,500 although the authority was limited to €2,000, which T did not know. After learning what A has done, P sends instructions about delivery of the machine. This implies ratification of A's act.

B. The effect of ratification

The effect of ratification is stated by paragraph (2): the act is regarded as having been authorised from the beginning. The principal takes over the benefits as well as the burdens produced by the act.

Illustration 2

The facts are as in Illustration 1. The market price rose the day after P had sent the letter of confirmation. Three days later T, alleging A's lack of authority, purports to avoid the contract. That is unjustified since P had ratified the contract and T can no longer invoke the lack of authority to escape the contract.

The purported principal may not yet be in existence or may not yet be identifiable at the time of the act (e.g. where a person acts in the name of a company which is not yet created or of a subcontractor who has yet to be selected). In such a case, the purported principal may still ratify the act later and will then be bound as from the moment of coming into existence or becoming identified. Special rules of the applicable company law with respect to pre-incorporation contracts take, of course, precedence.

C. Protection of other persons' rights

The question of the rights which other persons may have acquired is outside the scope of this Chapter.

D. Third party's right to set reasonable time for ratification

Paragraph (3) provides that the third party may by notice to the purported principal specify a reasonable period of time for ratification. If the purported principal does not ratify within that period ratification is no longer possible. The purpose of this rule, which is derived from the Unidroit Principles Article 2.2.9, is to prevent the principal from being able to keep a third party in a state of legal uncertainty for an indefinite time. The paragraph applies only if the third party knows that the representative had no authority. If the third party has reason to be uncertain, the appropriate course is for the third party to ask the representative to produce evidence of authority or to seek clarification of the position from the principal and in the meantime to withhold performance.

II.-6:112: Effect of ending or restriction of authorisation

(1) The authority of a representative continues in relation to a third party who knew of the authority notwithstanding the ending or restriction of the representative's

authorisation until the third party knows or can reasonably be expected to know of the ending or restriction.

(2) Where the principal is under an obligation to the third party not to end or restrict the representative's authorisation, the authority of a representative continues notwithstanding an ending or restriction of the authorisation even if the third party knows of the ending or restriction.

(3) The third party can reasonably be expected to know of the ending or restriction if, in particular, it has been communicated or publicised in the same way as the granting of the authority was originally communicated or publicised.

(4) Notwithstanding the ending of authorisation, the representative continues to have authority for a reasonable time to perform those acts which are necessary to protect the interests of the principal or the principal's successors.

COMMENTS

A. Basic idea

This Article deals with a predicament which may arise in several typical situations when a representative's authorisation comes to an end or is restricted. A third party who knew of the authority may not know of the ending or restriction; or the ending or restriction may be prohibited by a contract between the principal and the third party; or the ending of the authorisation may be so sudden that it does not allow the principal sufficient time to provide for a substitute. For the purposes of this Article it does not matter how the representative ceases to be authorised. The reason for the loss of authorisation does not matter. It may, for example, be an avoidance of the act granting the authority, or the expiration of a period of time, or termination or restriction by the principal.

In these cases, the interests of the third party and those of the principal, respectively, must be protected by providing for a limited continuation of the representative's authority.

B. Grounds for termination or restriction

The grounds for termination or restriction of the representative's authorisation are part of the law on the internal relationship between representative and principal and are dealt with in the Book on that topic (see Book IV.D. (Mandate)).

C. Continuation of authority in relation to third party

The effect of paragraph (1) is that the representative's authority, notwithstanding that authorisation has come to an end or been restricted, continues in relation to the third party until the third party knows or can reasonably be expected to know of the ending or restriction. This is an example of so-called "apparent" authority – authority derived by operation of law from the appearance of things

Paragraph (2) deals with the situation where the principal is under an obligation to the third party not to terminate or restrict the representative's authorisation. There are several

situations where this sort of arrangement is of practical importance and where the third party has to be able to rely on the grant of authority being irrevocable. Therefore, although it is not clear that the notion of irrevocable authorisation is known in all Member States' laws, paragraph (2) provides that in this case the authority of the representative continues notwithstanding the termination or restriction of the authorisation even if the third party does know of it. See also IV.D.-1:105 (Irrevocable mandate) for the internal relationship.

D. Communicated or publicised ending of authority

Paragraph (3) deals with a specific case of "constructive knowledge". An authorisation which has been addressed to a third party can be ended or restricted in the same manner in which it was granted. This is of particular importance if the grant of authority has been publicised, e.g. by a notice in a newspaper.

E. Continuation of an authority of necessity

Paragraph (4) adopts a useful innovation which goes beyond the law of most Member States but which is found in the Geneva Convention on Agency. It extends the representative's authority for a reasonable period, provided this is necessary for the protection of the principal's (or, in case of the principal's death or other extinction, a successor's) interests. There is no necessity if another representative has been granted authority immediately upon extinction or if the principal (or a successor) is in a position to undertake all necessary and urgent acts.

The extension of the representative's authority is only in time. By contrast, in substance it is restricted because it is limited to acts which are necessary for the preservation of the principal's interests.

CHAPTER 7: GROUNDS OF INVALIDITY

Section 1: General provisions

II.-7:101: Scope

(1) This Chapter deals with the effects of:

- (a) mistake, fraud, threats, or unfair exploitation; and*
- (b) infringement of fundamental principles or mandatory rules.*

(2) It does not deal with lack of capacity.

(3) It applies in relation to contracts and, with any necessary adaptations, other juridical acts.

COMMENTS

This chapter deals with various grounds on which a contract or other juridical act may be invalid. It deals not only with the invalidity as such but also with other effects of the ground of invalidity, including the possibility of obtaining damages whether or not the contract is avoided. Section 2 deals with what are often called vices of consent – mistake, fraud, threats or unfair exploitation - which have in common that they vitiate the consent which one party has given or apparently given to the conclusion of the contract or the making of the juridical act and make the contract or act voidable. The relevant intention to bring about a legal result was present and was duly manifested but it was there because of some reason which makes it objectionable to hold the party to it. Section 3 deals with what are often called illegality and immorality – namely the effects of an infringement of fundamental principles or mandatory rules. Here there may be no defect of consent or intention but the contract or other juridical act may nonetheless be so objectionable for other reasons that it should be void or voidable.

Although a lack of capacity may be a ground of invalidity, and may negate or vitiate consent or intention, this chapter does not deal with that topic because it is more a matter of the law of persons than of contract proper.

The question of unfair contract terms is covered in the next chapter. It involves rather different considerations and techniques.

It is important that the rules on grounds of invalidity should be capable of applying to juridical acts other than contracts and, in particular to unilateral promises intended to be binding without acceptance. Such acts may be the result of mistake or fraud or threats or unfair exploitation. They may infringe fundamental principles or mandatory rules. Paragraph (3) provides for the necessary extension. The rules of the Chapter can generally be applied without difficulty to juridical acts other than contracts. However, II.-7.203 (Adaptation of contract in case of mistake) will disapply itself because it depends on there being reciprocal obligations.

II.-7:102: Initial impossibility

A contract is not invalid, in whole or in part, merely because at the time it is concluded performance of any obligation assumed is impossible, or because a party is not entitled to dispose of any assets to which the contract relates.

COMMENTS

In some legal systems initial impossibility may preclude the formation of a contract or make a purported contract invalid. This approach is not taken here. Very often such cases will be ones of mistake under which either party affected may avoid the contract, but there may be cases when a party takes the risk of impossibility or should be treated as

taking that risk. An order for specific performance of the obligation will of course be unobtainable if performance is still impossible at the time when it falls due, but the party who has taken the risk may be liable in damages for non-performance.

Illustration

A sells to B, who is a salvage contractor, the wreck of an oil tanker which A says is at a particular location. As A should have known, there never was an oil tanker at that location, but B does not discover this until B's preliminary salvage expedition searches the area. The contract is valid and A is liable in damages to B.

The second situation covered by the Article – namely, where the seller of an asset is, at the time of conclusion of the contract, not entitled to dispose of it – is an even more clear case where it would be bad policy to preclude the formation of a contract. It might be perfectly possible for the seller to obtain the asset by the time the obligation to transfer ownership falls to be performed. In practice many contracts are entered into in relation to assets which do not yet exist but which are expected to exist by the time when the obligation falls to be performed.

Section 2: Vitiating consent or intention

II.-7:201: Mistake

(1) A party may avoid a contract for mistake of fact or law existing when the contract was concluded if:

(a) the party, but for the mistake, would not have concluded the contract or would have done so only on fundamentally different terms and the other party knew or could reasonably be expected to have known this; and

(b) the other party;

(i) caused the mistake;

(ii) caused the contract to be concluded in mistake by leaving the mistaken party in error, contrary to good faith and fair dealing, when the other party knew or could reasonably be expected to have known of the mistake;

(iii) caused the contract to be concluded in mistake by failing to comply with a pre-contractual information duty or a duty to make available a means of correcting input errors; or

(iv) made the same mistake.

(2) However a party may not avoid the contract for mistake if:

(a) the mistake was inexcusable in the circumstances; or

(b) the risk of the mistake was assumed, or in the circumstances should be borne, by that party.

COMMENTS

A. General

It frequently happens that a party concludes a contract on the basis of a misapprehension about the facts or the law affecting the contract. As will appear from the Notes, there are substantial differences between the laws of the Member States in the way in which such cases are conceptualised and also in the substantive outcomes. In particular, some systems are very reluctant to grant relief when a party has concluded the contract as the result of a “self-induced” mistake, rather than as the result of incorrect information given by the other party. Moreover, even if the other party becomes aware of the first party’s mistake, the other party may not be required to point it out. Others laws treat such conduct, depending on the circumstances, as contrary to good faith; and may allow a party to avoid a contract on the ground of a serious mistake even if it was self-induced and unknown to the other party. This Article (along with the following four Articles) seeks to set out principles which strike a fair balance between the voluntary nature of contract and protecting reasonable reliance by the other party. It does not purport to lay down rules which are “common principles” to be found in the different laws, though it reflects what is found in many of them. In appropriate cases, particularly in consumer contracts, the provisions of this Article will fall to be supplemented by rules on pre-contractual information duties, see Chapter 3, Section 1 (Information duties).

While the principle of freedom of contract suggests that a party should not be bound to a contract unless the consent to it was informed, the need for security of transactions suggests that the other party should in general terms be able to rely on the existence of the contract unless that other party:

- (a) has not acted in good faith; or
- (b) has taken deliberate advantage of the first party in circumstances in which standards of fair dealing would not permit this; or
- (c) has behaved carelessly or in some other way which was unreasonable.

Further, a party who has entered a contract under some mistake or misapprehension should not normally be entitled to avoid a contract unless the misapprehension was very serious. Thus a contract may be set aside for mistake only if the mistake is such that but for the mistake the mistaken party would not have concluded the contract or would have done so only on fundamentally different terms. The only exception is the case of fraud, where the intention to deceive is itself a sufficient ground to justify the innocent party having the power to avoid the contract.

If one of the conditions (a) - (c) above is satisfied, and, even on a correct interpretation of the contract, a party has made a mistake which is to something fundamental (see D below), there may be a case for a remedy.

It may also be appropriate to allow the contract to be avoided when a mistake which both parties shared has made the contract fundamentally different to what was anticipated. Here there was usually no bad faith, advantage-taking or careless behaviour at the time the contract was made, but this is a risk which neither party anticipated and which the contract did not allocate. In such a case it may be bad faith to insist on the contract being carried through when it has turned out to be fundamentally different from what either party anticipated.

B. Priority of interpretation

Before a remedy on the ground of mistake is allowed, it is frequently necessary to consult the contract and to interpret its provisions to see whether it in fact covers the situation which has now been revealed. If it does, there will be no ground for invoking mistake.

Illustration 1

A builder employed to build a house finds, when starting to dig the foundations, that across the site runs an old sewer which is not marked on the maps and which neither it nor the employer had ever expected. This will make completion of the task very much more expensive. It must first be determined whether the contract, as properly interpreted, covers the problem. If the contract provides that in the event of “unforeseeable ground conditions” the contractor is entitled to extra time and extra payment, and a correct interpretation of “unforeseeable ground conditions” would include the sewer, there is no basis for the contractor to invoke this Article.

C. Mistake must make contract fundamentally different

Security of transactions demands that parties should not be able to escape from contracts because of misapprehensions as to the nature or quality of the performance unless the mistakes are very serious. It is only in the case where the seller knows that the buyer would not enter the contract at all, or would only do so on fundamentally different terms, that the seller should be required to point out the buyer’s mistake. Less important misapprehensions must be borne by the party on whom they fall. Equally only very serious shared mistakes should give rise to relief. The Article therefore confines relief for mistake to cases where the other party knew or should have known that the mistaken party, if aware of the true situation, would not have entered the contract or would have done so only on fundamentally different terms.

It is not sufficient that the matter in question should have been “material” in the sense of being such as to merely influence the decision as to whether to contract or as to the terms on which to contract. A matter may be material in this sense without being fundamental. For example it might have slightly affected the price the mistaken party would have agreed to pay. A material difference between offer and acceptance may prevent the formation of a contract; but a mistake as to something which is material but not fundamental will not give rise to a right of avoidance under the present Article.

D. Mistakes caused by other party

Perhaps the most likely reason for a mistake is that the mistaken party has been given incorrect information by the other party, which has thus caused the mistake. When the resulting misapprehension is fundamental, the first party should be permitted to avoid the contract. Not only was the party not properly informed, but that resulted from the behaviour of the other party.

Even if the party giving the information reasonably believed it to be true, that party chose to give the information; and cannot complain if the recipient is allowed to avoid the contract provided that the resulting misapprehension was serious enough.

Illustration 2

The seller of the lease of a property which he had used for residential purposes told a prospective purchaser that the purchaser would be able to use it as a restaurant, which was the purchaser's main object. In fact the seller had forgotten that there was a prohibition on using the property other than for residential purposes without the landlord's consent and the landlord refuses consent. The purchaser of the lease may avoid the contract.

Depending on the facts of the case, the mistaken party may have a remedy under other Articles. For example, if the statement gave rise to a contractual obligation there will be a remedy for non-performance of the obligation. Even if the statement did not give rise to a contractual obligation there may be a remedy for fraud or a right to damages for loss caused by incorrect information which the party giving it had no reasonable grounds for believing to be true.

In these cases the misapprehension which results from the incorrect statement need not be fundamental. But if the conditions of (i) - (iv) are not met, or if there has been no fundamental non-performance or fraud and the mistaken party wants to avoid the contract, that may be done only on the basis of fundamental mistake under this Article.

There will also be ground for avoidance if the mistake was caused by the other party in some other way than by the giving of false information. For example, a party may have set up a website in such a way as to induce parties entering into contracts through that website to make certain errors.

E. Mistake known to other party

A party should not normally be permitted to remain silent, with the deliberate intention of deceiving the other party, on some point which might influence the other party's decision on whether or not to enter the contract. It is true that some legal systems within the EU as a general rule do allow a party to remain silent about important information, even if aware that it would influence the other's decision. That may be appropriate in certain cases, for example when the knowledgeable party has only gained the knowledge at considerable expense, or in highly competitive commercial situations (see Illustration 2

below), but as a blanket rule it is not appropriate. It does not accord with either commercial morality or what contracting parties will normally expect of each other. Unless there is a good reason for allowing the party to remain silent, silence is incompatible with good faith and will entitle the other party to avoid the contract under this Article.

The Article recognises a general principle that a party should not be entitled knowingly to take advantage of a serious mistake by the other as to the relevant facts or law. The same applies when it cannot be shown that the non-mistaken party actually knew of the mistake but where that party could reasonably be expected to have known of the mistake because it was obvious.

Illustration 3

A sells her house to B without revealing to B that A knows there is extensive rot under the floor of one room. She does not mention it because she assumes B will be aware of the risk of it from the fact that there are damp marks on the wall and will have the floor checked. B does not appreciate the risk and buys the house without having the floor checked. B may avoid the contract.

Illustration 4

Through extensive research, A discovers that demand for a particular chemical made by X Corporation is about to rise dramatically. A buys a large number of shares in X Corporation from B without revealing his knowledge, which he knows B does not share. B has no remedy.

F. Breach of pre-contractual information duties etc.

Paragraph (1)(b)(iii) deals with a situation where there is a breach, not of a general duty of good faith, but of a particular pre-contractual information duty or a duty to make available a means of correcting input errors and where that breach has caused the contract to be concluded. This provision therefore provides a sanction for duties laid down elsewhere in these rules (see Chapter 3, Section 1 (Information duties) and Chapter 3, Section 2 (Duty to prevent input errors) of this Book and the pre-contractual information duties laid down in Book IV in relation to specific contracts).

G. Shared mistake

When both parties conclude a contract under a serious misapprehension as to the facts the question is a different one. It must be asked whether the contract was intended to allocate the risk of the loss caused by the facts turning out to be different. Sometimes the parties realised that their knowledge was limited, or the contract was by its nature speculative; then it can be said that the contract was intended to apply despite the difference between what the parties assumed and reality. But sometimes it is more realistic to say that the risk of the facts turning out to be different was not allocated by the contract. If the result is that the contract would be very seriously different for one party, that party should have the right to avoid it. This usually results in the resulting losses being divided between the parties, if only in a very rough and ready way.

Illustration 5

An Englishwoman who owns a cottage in France agrees to rent it for one month to a Danish friend, although the Englishwoman does not normally rent the cottage. The lease is to start five days later. The Dane books non-refundable air tickets to fly to France. It is then discovered that the cottage had been totally destroyed by fire the night before the contract was agreed. The contract may be avoided by either party, with the result that no rent is payable and the Dane gets no compensation for the wasted air tickets.

H. No special categories

It is not necessary to lay down categories of misapprehension which will give rise, or not give rise, to a remedy for mistake. So the Article provides that the mistake may be about the facts surrounding the contract or the law affecting it. The Article does not apply to cases in which one party has performed the contract or intends to do so knowing that it involves an illegal act. The effects of illegality are covered separately.

Mistakes which relate to the mere value of the item sold are not usually fundamental. There is no explicit rule refusing any relief in this case.

Illustration 6

A woman pays €200,000 for an antique desk made by Chippendale. She agrees to this price because she has read that such prices were commonly paid for Chippendale desks a few years ago. She does not know that subsequently the market prices for antique furniture of all types have declined dramatically and that the desk is much less valuable than she supposed. She may not avoid the contract.

Cases of initial impossibility and the non-existence of a thing sold are treated in the same way as other mistakes. The contract may be avoided for mistake but it is not void for lack of an object. Indeed there may be cases in which a sale of a non-existent object is valid and the seller is liable for non-performance, because the court concludes that in the circumstances the seller should bear the risk.

Illustration 7

J sells K a piece of used equipment which is on a remote construction site from which K is to collect it; it is not feasible for K to inspect the equipment before agreeing to purchase. When K arrives there it finds that the equipment had been destroyed by fire some time before the contract was made. J should have known this. J is liable for non-performance and cannot avoid the contract for mistake.

See also Illustration 5 above.

Mistakes as to the person are treated in the same way as other mistakes.

I. Mistakes in communication

A frequent form of mistake is that one party makes some slip in communicating intentions, e.g. by writing 10,000 instead of 100,000. Such mistakes may be brought within the Article by virtue of the following Article.

J. Mistake inexcusable

It does not seem appropriate to allow a party who was a major cause of the mistake to avoid the contract because of it unless the other party was at least equally to blame. That would allow the first party to shift the consequences of the carelessness on to the other party. The other should not normally bear the burden of checking that the first party has not made careless mistakes. On the other hand, if the second party is aware that the first has made a mistake and it would take little trouble to point it out, the fact that the first party has been careless should not prevent relief and the mistake should not be treated as inexcusable.

Illustration 8

N asks for bids for a piece of construction work. The information given to tenderers indicates that the contractor will probably strike rock at one point on the site. O sends in a tender which has no item for excavating rock, only for excavating soil. N should point this out, and if it does not and the mistake is sufficiently serious, O should be able to avoid the contract.

K. Risk

There are some contracts under which the parties are deliberately taking the risk of the unknown, or should be treated as so doing. In such a case a party should not be able to avoid the contract for mistake if the risk eventuates. One example of this is where one party is well aware that the contract is being concluded without knowledge of an important matter but proceeds to conclude the contract anyway.

Illustration 9

A decides to sell at an auction the entire contents of a house he has inherited. He is conscious that he does not know the value of the items, but he deliberately decides not to bother to have them valued first. At the auction B buys a picture for a low price. B knows that it is by Constable but does not point this out. A cannot avoid the contract for mistake.

In other cases one party should be seen as taking the risk.

Illustration 10

A yacht chandler in England charters to a German amateur sailor a yacht which both parties believe to be moored at Marseilles. Unknown to either party, shortly beforehand the yacht had been sunk when it was rammed by another vessel. The chandler, being a professional dealing with a non-professional, and moreover being in a position to know the facts whereas the other party had no possibility of

this, may not avoid the contract but is liable for non-performance of the obligations under it.

L. Remedies

The normal remedy for mistake is for the mistaken party, or the one who wishes to escape from a contract entered under a shared mistake, to avoid the contract as a whole or in part. The question of damages is dealt with in other Articles but it may be noted here that the mistaken party may be able to recover damages where the mistake was the result of incorrect information given by the other party, or where the mistake was or should have been known to the other party, or was caused by the other party.

II.-7:202: Inaccuracy in communication may be treated as mistake

An inaccuracy in the expression or transmission of a statement is treated as a mistake of the person who made or sent the statement.

COMMENTS

A. No common intention: objective interpretation normal rule

It sometimes happens that because of an inaccuracy of expression in a communication, or an inaccuracy in its transmission, the communication does not express a party's true intention. For example, in an offer a party may write the price as €10,000 in mistake for €100,000. If the other party simply accepts this offer without noticing or pointing out the mistake, what should be the position should there later be a disagreement over the amount?

If the parties do not have a common intention, a party is normally bound by the apparent meaning of the expressions used, because the other party will reasonably have taken them at face value. So if the offeree does not know and has no reason to know that the offer contains a mistake, the offeree may hold the mistaken party to the contract.

This follows from the rules on interpretation in the next chapter.

B. Inaccuracy in communication may not prevent parties' having common intention

If in fact the recipient of the offer knows what the offeror meant, and accepts the offer without comment because the recipient too intended the price to be €100,000, the case is simply resolved: the parties' common intention was that the price should be €100,000 and the contract is for that sum even if the other party later uses the inaccuracy as a pretext for avoiding the contract.

This also follows from the rules on interpretation in the next chapter.

C. Objective rule does not apply if other party not misled by inaccuracy

A non-mistaken party who does not intend to accept an offer at €100,000, but knows that this is what was meant and simply accepts without pointing out the inaccuracy, should not be able to take advantage of the inaccuracy. On the contrary, such a party should be bound to a contract at that price. Although a party is normally bound by the objective meaning of words used, the meaning that a reasonable person would give to them, this does not apply when the recipient of the words does not understand them in this sense but as they were in fact intended. A contract results on the terms actually intended by the non-mistaken party.

This also follows from the rules on interpretation.

Illustration 1

A offers to sell B, another fur trader, hare skins at £1.00 per kg; this is a typing error for £1.00 per piece. Skins are usually sold by the piece and, as there are about six skins to the kilo, the price is absurdly low. B knows what A meant as skins are never sold by the kilo, always by the piece, but nonetheless B purports to accept. He cannot hold A to supplying skins at £1.00 per kilo; instead there is a contract at £1.00 per piece.

D. Party knows of inaccuracy but not what was intended

It sometimes happens that a party knows there has been an inaccuracy but not what was meant. Nonetheless the party simply accepts the offer or other communication without pointing the inaccuracy out. Then it would not be feasible to hold the party to whatever the mistaken party actually meant. Nonetheless, provided the mistake is fundamental the mistaken party should be able to avoid the contract. The present Article treats this as a form of mistake so that the mistaken party can seek to avoid the contract.

Illustration 2

A and B have been negotiating for a lease of A's villa; A has been asking 1,300 per month, B has offered 800 per month. A writes to B offering to rent him the villa for 100 per month; this is a slip of the pen for 1,000. B realises that A must have made a mistake but does not know what it is. He writes back simply accepting. A may avoid the contract.

E. Inaccuracy should have been known to other party

Even if a party did not know that the other had made an inaccuracy in a communication, that party should not necessarily be able to hold the mistaken party to the normal meaning of the words used.

If in the circumstances a reasonable person would not have interpreted the words in their usual meaning, but in the way in fact intended by the party making the communication, then under the rules on interpretation the other party will be held to this interpretation.

Illustration 3

As Illustration 1 above but it is not proved that B knew of the mistake. If, given the custom in the trade and the price offered, the meaning of A's communication should have been known to any reasonable person in the same circumstances, B cannot hold A to the apparent contract and is bound to buy at £1 per piece.

If it is not clear what the intended meaning was, the mistaken party may again seek to avoid the contract.

F. Mistake caused by other party

Sometimes a party makes a mistake in apparently agreeing to something because of the conduct of the non-mistaken party. The non-mistaken party cannot hold the mistaken party to the apparent agreement if the non-mistaken party should have realised that the other might be agreeing to something in error.

Illustration 4

A books a package holiday with B Company. B offers various tours as well as the flight and hotel accommodation. A does not want these tours as they are very expensive, but the booking form used by B is very hard to follow and by mistake A checks a box indicating that she wants all the tours. B cannot hold A to this.

G. Fault of mistaken party

Under the preceding Article, relief is denied to a party if the mistake was inexcusable. This is justified by the need for security in transactions; the other party should not be put to the burden of investigating all the many possible misapprehensions that the other party might be labouring under; but should at least be able to ignore any which could only arise through gross carelessness. Usually mistakes in communication of the kind discussed above are careless, but this does not necessarily mean that they are inexcusable. In any event the concept of "inexcusable" is a relative one. When the mistake is not about the facts or law but is a problem of the accuracy of the communication, it is much less burdensome to ask the other party just to check any apparent statement which looks as if it might be a mistake, even when the mistake was due to the mistaken party's carelessness. The non-mistaken party has only to ask, "You do mean what you say on page 2?", or "You are aware of clause x?" The fact that the mistaken party was seriously at fault is not necessarily a bar to relief.

H. Seriousness

It is necessary to restrict relief to mistakes which make the contract fundamentally different. To allow relief for lesser mistakes would undermine the security of transactions. This applies equally to relief where there has been an inaccuracy in communication.

I. Mistake in communication treated as mistake of sender

It sometimes happens that a mistake occurs in the transmission of a communication sent via a third party, such as a telegraph company, without any fault on the part of the sender. Nonetheless the sender, having chosen that form of communication must bear the risk. Under these rules the situation is treated just as if the mistake had been caused by the sender, except in one situation. This is where the need for a notice has been caused by the recipient's non-performance of an obligation. Here, by virtue of a later Article (III.-3:106 (Notices relating to performance)) the dispatch principle applies and the risk of an inaccuracy in the transmission of the notice is borne by the recipient.

II.-7:203: Adaptation of contract in case of mistake

(1) If a party is entitled to avoid the contract for mistake but the other party performs, or indicates a willingness to perform, the obligations under the contract as it was understood by the party entitled to avoid it, the contract is treated as having been concluded as that party understood it. This applies only if the other party performs, or indicates a willingness to perform, without undue delay after being informed of the manner in which the party entitled to avoid it understood the contract and before that party acts in reliance on any notice of avoidance.

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

(3) Where both parties have made the same mistake, the court may at the request of either party bring the contract into accordance with what might reasonably have been agreed had the mistake not occurred.

COMMENTS

A. Mistake which was or should have been known to other party

The most obvious application of this Article is when a party is entitled to avoid a contract because there was an error in communication, but the non-mistaken party did not know what the mistake was. If, when told what the mistake was, that party offers to perform according to what the mistaken party actually intended, the latter's right to avoidance should be lost.

The Article may also apply to mistakes as to facts or law.

Illustration 1

A flooring contractor employed to floor a large building makes a fundamental mistake over the amount of work needed. This mistake should have been known to the other party. So the contractor has the right to avoid the contract. The employer offers to release the contractor from the extra work without any reduction in the payment. The contractor cannot avoid the contract.

B. Shared mistake

In cases in which the contract may be avoided because both parties have made the same mistake, paragraph (1) applies. Thus if one party seems to stand to benefit from the mistake and the other to lose, the first may offer to perform in the way the contract was originally understood. But if it is not clear that one stands to lose more than the other, or the gaining party is not prepared to perform the contract as it was originally understood, it may be more appropriate to adjust the contract than simply to avoid it. In this case paragraph (3) permits either party to apply to the court for the contract to be adjusted in such a way as to reflect what might have been agreed had the mistake not occurred.

Illustration 2

The facts are as in Illustration 1 except that both parties were mistaken as to the amount of work needed. The employer may indicate a willingness to release the contractor from the extra work under paragraph (1). Alternatively, either party may request the court to adapt the contract under paragraph (3). In such a case the court might apply the contract rates to the additional work, with appropriate adjustments for the volume of work involved.

Sometimes it will be clear that, but for the mistake, the parties would not have entered the contract. In this case adaptation will not be appropriate.

Illustration 3

A sells a painting, which the parties think is by a little known artist, to B for €500. It is then discovered that the painting is by a very well known artist and is worth €50,000. B could not possibly have paid €50,000. A may avoid the contract; it should not be adapted so that B has to pay A the true value of the painting.

Equally a subsequent change in one party's position may make adaptation inappropriate

Illustration 4

The parties to a building contract were both mistaken in thinking that it would involve less work than is actually the case. Had the true quantity of work been known, the builder would have agreed to do all the work at the same unit prices as in the contract, but subsequently it has taken on other work and cannot do the extra work on this contract. Adaptation is not appropriate and the contract may be avoided.

C. Damages after adaptation of contract

The adaptation of the contract by the other party or by the court under this Article does not preclude the mistaken party claiming damages for any loss which is not compensated by the adaptation of the contract.

II.-7:204: Liability for loss caused by reliance on incorrect information

(1) A party who has concluded a contract in reasonable reliance on incorrect information given by the other party in the course of negotiations has a right to damages for loss suffered as a result if the provider of the information:

(a) believed the information to be incorrect or had no reasonable grounds for believing it to be correct; and

(b) knew or could reasonably be expected to have known that the recipient would rely on the information in deciding whether or not to conclude the contract on the agreed terms.

(2) This Article applies even if there is no right to avoid the contract.

COMMENTS

A. General effect of Article

This Article reflects the idea that a party to contractual negotiations should not act in an irresponsible way in giving information to the other party on which the other party may rely. The Article can be regarded as a concretisation of the requirement of good faith and fair dealing. It would be possible to locate this provision in the Book on Non-contractual Liability for Damage Caused to Another but, because it is so closely related to the conduct of a party in contractual negotiations, it seems likely to be for the convenience of users to place it here

A party who gives information to the other during the course of negotiations may in some circumstances be treated as undertaking a contractual obligation by making the statement. But not all statements of fact are treated as giving rise to a contractual obligation.

Even if the statement does not give rise to a contractual obligation, a party should not necessarily be expected to take the risk of the information given by the other party being incorrect. If the incorrect information leads the recipient party to make a mistake justifying avoidance of the contract, or if it amounts to fraud on the recipient party, that party will have a right to avoid the contract for mistake or fraud and to damages for loss under the rules on those topics. But even if the matter is not such as to give rise to a right to avoid the contract, the misled party should have a right to reparation if the other party has given incorrect information recklessly or carelessly.

B. Who should bear the risk of information being incorrect?

Where there is no fraud, the incorrect information is in a sense an accident which befalls the making of the contract. In some cases the party providing the information may have believed it to be correct and had good reason to believe it was correct. In those circumstances, it seems fair to leave the loss caused where it falls (unless it makes the contract fundamentally different, in which case the contract may be avoided under the rules on mistake). If, on the other hand, the party who has given the information believed

the information to be incorrect or had no reasonable grounds to believe it to be correct, [and knew or could reasonably be expected to have known that recipient would rely on it], then the misled party should have a remedy. The Article confers a right to damages where incorrect information has been given in these circumstances.

The remedy will apply even if the incorrect information was not the only or principal reason the misled party entered into the contract. However the damages should compensate only for the loss which has been caused by the incorrect information.

The first limb of the double test (*believed the information to be incorrect or had no reasonable grounds to believe it to be correct*) is necessary because there could be cases where a person has reasonable grounds for believing information to be correct but has other grounds for believing it to be incorrect and actually believes it to be incorrect. For example, a seller of livestock may have had it inspected by a government inspector who pronounced it healthy. This provides reasonable grounds for believing it to be healthy. However, the seller may be more knowledgeable and experienced than the inspector and may actually believe, with good reason, that it is unhealthy. In such circumstances it would be contrary to good faith to say that the livestock was healthy. The second limb is necessary because a person involved in negotiations should not be so irresponsible as to provide information to the other party which the provider has no reasonable grounds for believing to be correct, even if the provider has no knowledge or belief either way on the question of its correctness.

C. Party could have discovered truth

Even when the party giving the information believed the information to be incorrect or had no reasonable grounds to believe it to be correct, it would not be appropriate to give damages if, in the circumstances, it was unreasonable for the party given the information to rely on it, or to rely on it without checking it. This is why the Article refers to “reasonable” reliance.

Illustration 1

E, an elderly lawyer who wishes to retire, invites F to buy his practice. He tells F that the income of the practice is €90,000 per year. It is normal for the buyer of such a practice to have the account books checked very carefully before deciding to purchase. E makes the books available. In fact, as an examination of the accounts would have shown, the practice has suddenly become much less valuable, though E does not know this because, due to illness, he has not been paying attention to the figures. F buys the practice without checking the accounts. It is so unreasonable to buy a practice without checking the accounts that F could not recover damages.

D. Information given by the other party

The Article applies only to incorrect information given by the other party to the contract. This, however, must be read with the Article which attributes to a person the statements or conduct of certain other persons for whom that person was responsible. A party misled

by information provided by a third person falling outwith these categories cannot recover damages.

Illustration 2

G leased a machine from H, relying on a statement made by J, a friend who has a similar machine, that its fuel consumption was 5 litres per hour. In fact the fuel consumption was much higher. G may not recover damages from H.

However, if the party who was given the information was dealing with a professional supplier and the information was given by someone earlier in the business chain (e.g. a party buys goods from a retailer relying on information from the manufacturer), the party will have a remedy for non-performance under the Article on Statements giving rise to contractual obligations.

E. Remedies

The party misled by incorrect information is entitled to reparation for the loss which the incorrect information has caused. As the assumption for present purposes is that the incorrect statement did not give rise to a contractual obligation, the injured party is not entitled to damages on the normal contractual basis (that is, the difference between the value of what was received and the value of what would have been received had the information been correct), but only to compensation for the loss actually caused by the incorrectness of the information (that is, the difference between the value of what was received and the amount paid).

Illustration 3

A sells B a used car, telling B that the car has done only 50,000 kms. B agrees to pay €100,000 for the car, although the market price for that model of car with 50,000 kms on the clock is €105,000. In fact the car has done 150,000 kms and is worth only €85,000. On the assumption that the statement does not in the circumstances give rise to a contractual obligation, B may recover damages of €15,000 (and not the €20,000 which would have been due if the statement had given rise to a contractual obligation).

Where the incorrect information causes the misled party loss beyond the difference in value between what was given and what was received (this further loss is sometimes called "consequential" loss), the party may recover this also.

Illustration 4

C employs D, a firm of contractors, to lay a road across a field. C tells D that the ground all over the site has been investigated and is quite firm. In fact part of it is a quagmire. D discovers this when one of its machines sinks into it. Not only does the soft ground make the job much more expensive but D has to pay €100,000 to have its machine recovered. It may recover the €100,000.

F. Relationship to other rights to reparation

Book IV (Non-contractual Liability for Damage Caused to Another) has a provision on liability for loss caused by detrimental reliance on incorrect advice or information. The provision applies, however, only if the advice or information is provided by a person in pursuit of a profession or in the course of trade. It is therefore narrower in scope than the present Article in that respect but wider in others. It provides expressly that the present Article is unaffected by its provisions. Clearly, therefore, there could be an overlap between the two provisions. That does not matter: the aggrieved person could choose which Article to rely on.

II.-7:205: Fraud

(1) A party may avoid a contract when the other party has induced the conclusion of the contract by fraudulent misrepresentation, whether by words or conduct, or fraudulent non-disclosure of any information which good faith and fair dealing, or any pre-contractual information duty, required that party to disclose.

(2) A misrepresentation is fraudulent if it is made with knowledge or belief that the representation is false and is intended to induce the recipient to make a mistake. A non-disclosure is fraudulent if it is intended to induce the person from whom the information is withheld to make a mistake.

(3) In determining whether good faith and fair dealing required a party to disclose particular information, regard should be had to all the circumstances, including:

- (a) whether the party had special expertise;*
- (b) the cost to the party of acquiring the relevant information;*
- (c) whether the other party could reasonably acquire the information by other means;*
and
- (d) the apparent importance of the information to the other party.*

COMMENTS

A. General policy

In a case of fraud there is no reason to protect any interest the fraudulent party may have in upholding the contract; nor is the risk of being deliberately misled one that a party should be expected to bear.

B. Nature of representation

A representation is a definite statement that something is the case. It does not matter whether the fraudulent statement is as to facts or law.

The statement must be as to matters existing at the time of the contract. A statement that a party intends to do something does not become a false representation within the Article simply because the party has a change of mind. For such a change of mind to give rise to

a remedy, it will have to be shown that the party's statement of intention amounted to a contractual promise. However, if a person states that he or she holds an intention which in fact is not held, that is a false representation within this Article.

Statements which are obviously mere sales talk are not representations within this Article.

Illustration 1

A leases a computer to B. A casually remarks that the computer is "the best of its size on the market". In fact a more powerful machine of similar size is available. As buyers may disagree over whether a more powerful machine is necessarily "better", B does not have a remedy.

A statement of opinion does not normally amount to a representation of fact or law. The fact that the statement is expressed as an opinion should warn the other party that it may or may not be accurate. However, a false statement that a party thinks something will be a false statement of fact.

Illustration 2

C rents a country cottage to D, telling D that in C's opinion the cottage is a very quiet spot. In fact C knows that it is under the flight path of the nearest airport and at certain times is very noisy. C has made a fraudulent misrepresentation.

C. Form of the misrepresentation

It does not matter whether the incorrect information is given by words or takes the form of misleading conduct.

Illustration 3

A leases a house to B. The house suffers severely from damp but just before leasing it A has had the walls repainted to conceal the damp, which B therefore does not notice. B may avoid the contract.

D. Fraud must be intentional

The effect of paragraph (2) is that a party's misrepresentation or non-disclosure is fraudulent if it was intended to deceive – that is, to cause the other party to make a mistake. This is in accordance with the definition of fraudulent for other purposes of the model rules. It is not fraud, however, to fail to point out some fact of which the other party is ignorant if there was no intention of deception. The mistake need not be such a mistake as would justify avoidance in itself.

E. Reliance

The party given incorrect information will not have a remedy unless that party has relied on the information in deciding to enter the contract.

Illustration 4

A sells a used car to B after turning back the odometer so that it shows that the car has done much less than the distance the car has been driven. However B never looks at the odometer until after she has bought the car. B has no remedy for fraud.

F. Non-disclosure

A party should not normally be permitted to remain silent, with the deliberate intention of deceiving the other party, on some point which might influence the other party's decision on whether or not to enter the contract. Unless there is a good reason for allowing the party to remain silent, silence is incompatible with good faith and will entitle the other party to avoid the contract under this Article.

Often a party to whom a fundamental fact has not been disclosed will be entitled to avoid the contract for mistake. There may also be a right to damages. Otherwise there is no general duty to point out to the other party possibly disadvantageous facts, but still a party should not normally be entitled to keep quiet with the intention of deceiving the other party.

G. Non-disclosure consistent with good faith and fair dealing

The duty to disclose is part of a general notion of good faith and fair dealing and may not always require a party to point out facts of which the other is known to be ignorant. For example, while a professional party will often be required by good faith and fair dealing to disclose information about the property or services to be supplied under the contract, the same may well not be true of a non-professional party. (See paragraph (3)(a).)

Further, a party may fairly be expected to provide information about the performance that party is undertaking, but is less likely to be required to do so about the performance the other party is to make. The latter is normally expected to know or find out relevant facts about such performance. (See paragraph (3)(c). In particular there may not be any obligation to disclose information which concerns the other party's performance and which the informed party had to make a great investment in order to acquire. (See paragraph (3)(b).)

The list in paragraph (3) is not intended to be exhaustive.

G. Remedies

Fraud gives the misled party the right to avoid the contract, if notice is given within a reasonable time. Where the fraud relates to an individual term of the contract, the party may be able to avoid the contract partially. In addition to, or instead of, avoiding the contract the party may recover damages. These will be limited to recovery of the amount the party is out of pocket, since it is assumed for present purposes that the other party did not give a contractual undertaking that the representation was true.

Illustration 5

C, an art dealer, sells a picture to D stating that in his opinion, but not undertaking that, it is by a well-known artist. D pays €5,000 for the picture. D later discovers that it is not by that well-known artist but is by a lesser known artist, as C knew perfectly well. It is worth only €1,000. If it had been by the well-known artist it would have been worth €9,000. If D decides to keep the picture she may recover damages limited to €4,000.

H. Incorrect information amounts to non-performance

In some cases the giving of incorrect information may give rise to a contractual obligation. The fact that the information is incorrect will amount to a non-performance of the obligation. In this case the party misled will have the usual remedies for non-performance.

Illustration 6

As in 5 but C states categorically that the picture is by the well-known artist. B may obtain remedies for non-performance which may include damages of €8,000.

I. Remedies cannot be excluded

Fraud can never be justifiable and therefore it is provided later that the remedies for it cannot be excluded or restricted.

II.-7:206: Coercion or threats

(1) A party may avoid a contract when the other party has induced the conclusion of the contract by coercion or by the threat of an imminent and serious harm which it is wrongful to inflict, or wrongful to use as a means to obtain the conclusion of the contract.

(2) A threat is not regarded as inducing the contract if in the circumstances the threatened party had a reasonable alternative.

COMMENTS

A. Introduction

The notion of freedom of contract suggests that a party should only be bound by actions which were both voluntary and free, in the sense that the party had some choice. In practice the notion of freedom has to be tempered. On the one hand, a person who is made to sign by the other grabbing the arm and moving it simply does not consent and has not even appeared to agree. In such a case there would not be an agreement within these rules. On the other hand, there are frequent occasions when the choices facing a person are so constrained by circumstances as to give rise to a feeling that he or she has to agree to a contract. During food shortages a hungry person may have little choice but to pay the high market price for food. The law of contract, dependent as it is on notions of

the market, cannot insist that every contract should be free from such constraints. In some such cases the following Article (Unfair exploitation) may apply.

The law can insist that a party should not be constrained by the actions of the other party when those actions are unjustifiable. A person should not be bound if the person's consent was obtained by coercion or by threats of an unjustifiable type.

B. Coercion

Consent is vitiated if a person is coerced into doing something. Normally coercion will involve the use of threats but this is not necessarily so. There may be a situation of such dominance that one party can force the other person to act by simply giving an order. Often there will be implied threats in the background but it should not be necessary to imply threats artificially if there was factual coercion in the absence of threats.

C. Threats of acts wrongful in themselves

A party should not be able to hold the other to a contract which the other agreed to as the result of a threat that some other legal wrong would be inflicted on the first party.

Illustration 1

A and B are partners. A wishes to buy B's share of the business and, in order to induce B to sell her share, threatens to have some goods belonging to B wrongfully seized and impounded if she does not sell. B agrees to sell her share to A. B may avoid the contract.

The same would follow if A had threatened a third party, e.g. a member of B's family. It is not only threats of physical violence or damage to property which constitute wrongful threats. A threat to inflict economic loss wrongfully, e.g. by breaking a contract, can equally constitute duress.

Illustration 2

X owes a large debt to Y. Knowing that Y desperately needs the money, X tells Y that he will not pay it unless Y agrees to sell X a house which Y owns at a price well below its market value. Faced with bankruptcy, Y agrees. X then pays the debt. Y may avoid the contract to sell the house.

In practice the threat of a breach of contract is often used in an attempt to secure re-negotiation of the same contract. In this case the re-negotiation agreement may be avoided.

Illustration 3

C has agreed to build a ship for D at a fixed price. Because of currency fluctuations which affect various subcontracts, C will lose a great deal if the contract price is not changed and it threatens not to deliver unless D agrees to pay

10% extra. D will suffer serious harm if the contract is not performed. D pays the extra sum demanded by C. D may recover the extra sum paid.

D. Not every warning of non-performance amounts to a threat

If one party genuinely cannot perform the contract unless the other party promises to pay an increased price and the first party simply informs the second of this fact, the second party cannot later avoid any promise to pay a higher price. The first party's statement was merely a warning of the inevitable; there is no threat within the meaning of this Article.

Illustration 4

A employs a company, B, to build a road across A's farmland at a fixed price. B finds that the land is much wetter than either party had realised and B will literally be bankrupt before it has performed the contract at the original price. B informs A of this and A agrees to pay an increased price. Although A had no real choice, A cannot avoid the agreement to pay the increased price.

E. Threats of lawful acts wrongfully used

Even a threat to do something lawful may be illegitimate if it is not a proper way of obtaining the benefit sought, as in blackmail.

Illustration 5

E threatens his employer F that he will reveal to F's wife F's affair with his secretary unless F increases E's wages. F complies. He may avoid the agreement to pay E the higher wages.

F. Threat must have led to the contract

Relief will not be given unless the threat did influence the threatened party's decision. If the primary reason for paying the amount demanded is to settle the dispute rather than to avoid the threatened action, relief will not be given.

Illustration 6

A company, E, employs a firm of contractors, C, to do some building work. C has underpriced the work and tells E that it will not do it unless the price is increased. E is not much affected by the threat, which it regards as a bargaining ploy, but feels that C has made a genuine mistake and deserves a better price. So it agrees to pay the extra. It cannot avoid the agreement to pay extra.

Provided the threat has some influence it need not be the only reason for the contract.

Illustration 7

A and B are partners. A wishes to buy B's share of the business and, in order to induce B to sell his share, threatens to have B murdered if he does not sell. B agrees to sell his share to A. Even if B also has good business reasons for selling to A, B may avoid the contract.

G. No reasonable alternative

Relief will not be given if a party gave in to a threat when there was a perfectly good alternative - e.g. the party could have found someone else to do the work, or could have obtained an order forcing the other party to do it. If there was a reasonable alternative, which suggests that the threat was not the real reason for the threatened party agreeing to the demand. The burden of proving that the threatened party had a reasonable alternative rests on the party making the threat.

H. Remedies

The party coerced or subjected to the threat may avoid the contract, provided notice is given within a reasonable time. There may also be a right to damages.

I. No exclusion of remedies

Coercion or threats are forms of wrongful behaviour and therefore it is provided later that the remedies cannot be excluded or restricted by contrary agreement.

II.-7:207: Unfair exploitation

(1) A party may avoid a contract if, at the time of the conclusion of the contract:

(a) the party was dependent on or had a relationship of trust with the other party, was in economic distress or had urgent needs, was improvident, ignorant, inexperienced or lacking in bargaining skill and

(b) the other party knew or could reasonably be expected to have known this and, given the circumstances and purpose of the contract, exploited the first party's situation by taking an excessive benefit or grossly unfair advantage.

(2) Upon the request of the party entitled to avoidance, a court may if it is appropriate adapt the contract in order to bring it into accordance with what might have been agreed had the requirements of good faith and fair dealing been observed.

(3) A court may similarly adapt the contract upon the request of a party receiving notice of avoidance for unfair exploitation, provided that this party informs the party who gave the notice without undue delay after receiving it and before that party has acted in reliance on it.

COMMENTS

A. Binding force of contracts and unfair exploitation

Contract law does not in general insist that bargains be fair in the sense that what is to be supplied or provided by each party should be objectively of equal value. Although some systems allow contracts, or certain types of contract, to be avoided simply on the ground that the price is grossly unfair (*lésion*), it is commonly held that the parties are the best judges of the relative values of what is to be exchanged. However many systems refuse to uphold contracts which involve an obviously gross disparity in these values when this

appears to be the result of some bargaining weakness on one side and conscious advantage-taking on the other. This is the approach taken by this Article

The Article adopts the principle that a contract which gives one party excessive advantage and which involved unfair exploitation may be avoided or modified at the request of the disadvantaged party.

B. Weakness or need essential

It would create too much uncertainty if a party could escape from a contract, even if it is disadvantageous, when there is no apparent reason why the party did not take better care when agreeing. Relief should only be available when the party can point to some need, weakness or disability to explain what happened. This may include the fact that the party had a confidential relationship with the other party and was relying on the other for advice, if this meant that the party was not exercising independent judgement.

C. Knowledge of party obtaining advantage

It would also create too much uncertainty to upset contracts which are one-sided when the party who gains the advantage neither knew nor could reasonably be expected to have known that the other party was in a weaker position. In such circumstance the stronger party cannot reasonably be required to have any special regard to the weaker party's interests.

D. Excessive benefit

The Article applies where the benefit gained by one party is demonstrably excessive in comparison to the "normal" price or other return in such contracts. The fact that a shortage of supply has led to generally high prices is not a ground for the application of this Article, even if the sudden price increase has allowed one party to make an abnormally high profit.

Illustration 1

During a sudden cold snap during early summer the price of tomatoes increases dramatically. B agrees to buy tomatoes from A at the increased price. B cannot avoid the contract under this Article even though B discovers that A had bought the tomatoes at a much lower price earlier in the summer and had kept them in cold store.

Where however a party takes advantage of another's ignorance or need to make a particularly one-sided contract, this Article will apply.

Illustration 2

X, an uneducated person with no business experience, is left some property. He is contacted by Y who offers to buy it for a sum much less than it is actually worth; telling X that he must sell quickly or he will lose the chance. X agrees without consulting anyone else. X may avoid the contract.

Illustration 3

U and her family are on holiday abroad when they are involved in a car crash and U's husband is badly hurt. He urgently needs medical treatment which is not locally available. V agrees to take the man by ambulance to the nearest major hospital, charging approximately five times the normal amount for such a journey. U is so worried that she agrees without getting other quotations; she does not discover until later that she has been overcharged. She may obtain relief.

Illustration 4

The facts are as in the last Illustration. U realises that V is demanding an extortionate price but this is the only ambulance available. She may obtain relief.

E. Grossly unfair advantage

The Article may apply even if the exchange is not excessively disparate in terms of value for money, if grossly unfair advantage has been taken in other ways. For example, a contract may be unfair to a party who can ill afford it even if the price is not unreasonable.

Illustration 5

X, a widow, lives with her many children in a large but dilapidated house which Y, a neighbour, has long wanted to buy. X has come to rely on Y's advice in business matters. Y is well aware of this and manipulates it to his advantage: he persuades her to sell it to him. He offers her the market price but without pointing out to her that she will find it impossible to find anywhere else to live in the neighbourhood for that amount of money. X may avoid the contract.

F. Risk taking

Relief should not be given when the apparent one-sidedness of the bargain is the result of a party gambling and losing. The contract was not unfair when it was made, even though it may have turned out badly for one party.

G. Remedies

It may not be appropriate simply to set aside the contract which is excessively advantageous. The disadvantaged party may wish the contract to continue but in modified form. Under paragraph (2) the court may therefore substitute fair terms. This goes further than a right of partial avoidance, since it allows the substitution of a fair term.

Conversely it may not be fair to the party who gained the advantage simply to avoid the whole contract; that could result in unfairness the other way. So the court has power to adapt the contract at the request of either party, provided the request so to do is made promptly and before the party who has received a notice of avoidance has acted on it.

The court should adapt the contract only if this is an appropriate remedy in the circumstances. For example, adaptation would not be appropriate in a case like Illustration 5 above.

In addition to or instead of avoidance the disadvantaged party may recover damages; these are limited to the amount by which the party is worse off compared to the position before the contract was made (the "reliance interest"). Damages are dealt with later.

H. Remedies cannot be excluded

Since unfair exploitation of another's weakness or distress in the circumstances covered by this Article is unconscionable, it is provided later that the remedies for unfair exploitation cannot be excluded or restricted by agreement.

II.-7:208: Third persons

(1) Where a third person for whose acts a party is responsible or who with a party's assent is involved in the making of a contract:

(a) causes a mistake, or knows of or could reasonably be expected to know of a mistake; or

(b) is guilty of fraud, coercion, threats or unfair exploitation, remedies under this Section are available as if the behaviour or knowledge had been that of the party.

(2) Where a third person for whose acts a party is not responsible and who does not have the party's assent to be involved in the making of a contract is guilty of fraud, coercion, threats or unfair exploitation, remedies under this Section are available if the party knew or could reasonably be expected to have known of the relevant facts, or at the time of avoidance has not acted in reliance on the contract.

COMMENTS

A. Responsibility for agents, employees and others

A party is generally treated as responsible for not just the actions of employees but also of those whom the party involves in the making of the contract or to whom performance is delegated. This applies just as much to behaviour or knowledge which might invalidate a contract as to other things. The contracting party will be liable just as the third person would have been had the contract been made with the third person. Normally the third person will be acting on behalf of the party against whom the remedy is sought, but this need not be so if the third party was involved with the party's assent; it need not be shown that the third party was acting for the party.

Illustration 1

A supplier of goods holds an informal negotiation with a buyer; another customer is present and with the supplier's assent joins in the discussion. Out of the supplier's hearing, the other customer gives the buyer some inaccurate information. The buyer should have a remedy just as if the information had been given by the supplier, without having to show that the other customer was acting on the supplier's behalf.

B. Remedies where fraud, etc. by a third person for whom party is not responsible

There are some legal systems within Europe which allow a party to avoid a contract concluded as the result of an improper threat whoever made the threat. However, it is more generally considered that a party should not be fixed with the consequences of improper or careless behaviour of a third person for whom that party is not responsible and who does not fall into the other categories mentioned in Comment A. To permit avoidance of the contract for such reasons risks undermining the party's reasonable reliance on the contract and might deter people from making contracts that in fact would benefit all parties. Thus if a contract to provide personal security for a loan made by a bank could be avoided by the security provider on the ground that the security provider had been threatened by the debtor or some third party, even though the bank had no way of discovering that fact, banks might be deterred from making loans which need to be secured in this way. The result would be a reduction in the availability of credit.

In contrast, the party should not be allowed to enforce a contract if the party knows or should know that the contract was concluded only through behaviour by a third person which, if by a contracting party, would give rise to a remedy under the foregoing provisions of this Chapter

Illustration 2

A bank lends money to a husband's business on the strength of a charge, signed by the wife, over the family home. The charge is very much against the wife's interest and the husband has procured the wife's signature by duress. The bank ought to know that it is most unlikely that the wife would sign voluntarily and the bank cannot enforce the charge. It should have made enquiries to ensure that the wife was acting freely.

The party should also be liable for damages if the party knows of the ground for avoidance, but does not inform the other party that the information is incorrect.

C. Remedy when party knows of mistake

A party may also know of a mistake which was known to or caused by a third person. There is no need for a special rule to cover this case since a party may avoid a contract entered under a mistake if the mistake was known to the other party.

D. No reliance on contract by other party

It also seems fair to allow a party who has concluded a contract because of the fraud, etc of a third person, or because of a mistake which was or should have been known to the third person, to avoid the contract, even if the other party to the contract did not know or have reason to know of the circumstances, provided the party seeking to avoid the contract can prove that the other party has not yet acted in reliance on it, even by passing up other opportunities.

II.-7:209: Notice of avoidance

Avoidance under this Section is effected by notice to the other party.

COMMENTS

Avoidance may be effected by the party entitled to avoid the contract; it is not necessary to seek a court order to avoid the contract.

Under the normal rules on notice, the receipt principle applies and the avoidance will not be effective unless the notice reaches the other party. Under the normal rules on notice, the notice may be given by any means appropriate to the circumstances. In informal circumstances it need not be in writing and need not use technical legal terms. The requirement of good faith and fair dealing will often require the notice to give some indication, even if only in lay person's language, of the reason for the avoidance, unless this can be regarded as already obvious to the receiving party. Statements or conduct by a party unequivocally indicating that, because of the facts giving ground for avoidance, the party is no longer to be regarded as bound by the contract may amount to notice of avoidance if made known to the other party.

Illustration

A takes a job as manager with B's firm after B makes fraudulent statements about the commission which previous managers have made with the firm. After A discovers the truth, he protests about B's dishonesty and says he is considering what to do. He then takes a job with another firm and informs B of this. Taken together A's statements and conduct amount to notice of avoidance.

Provided the time limit for avoidance has not passed, a party may give notice of avoidance by raising the ground of avoidance as a defence to an action on the contract brought by the other party.

II.-7:210: Time

A notice of avoidance under this Section is ineffective unless given within a reasonable time, with due regard to the circumstances, after the avoiding party knew or could reasonably be expected to have known of the relevant facts or became capable of acting freely.

COMMENTS

A. Party must take avoiding action with reasonable speed

The need for security in transactions requires that the party entitled to avoid a contract should do so within a reasonable time after learning of the relevant facts or becoming free

of the coercion, threats or influence of the other party, rather than within the much longer time limits allowed by some laws.

B. Knowledge of facts

The party should act within a reasonable time of learning the relevant facts; it is not necessary that the party should know that the facts give rise to a right to avoid the contract. If in doubt, the party should take legal advice. A reasonable time will include time to take advice and consider the position.

II.-7:211: Confirmation

If a party who is entitled to avoid a contract under this Section confirms it, expressly or impliedly, after the period of time for giving notice of avoidance has begun to run, avoidance is excluded.

COMMENTS

A party cannot be allowed to avoid a contract after indicating a wish to continue with it, since the other party may act in reliance on the contract continuing. The first party's indication may be made expressly or impliedly by conduct, e.g. by continued use of goods.

In cases of mistake and fraud, this rule only applies once the party who may have been entitled to avoid knows of the relevant facts and, in cases where there has been some form of coercion, it only applies when the party becomes capable of acting freely.

II.-7:212: Effects of avoidance

(1) A contract which may be avoided under this Section is valid until avoided but, once avoided, is retrospectively invalid from the beginning.

(2) The question whether either party has a right to the return of whatever has been transferred or supplied under a contract which has been avoided under this Section, or a monetary equivalent, is regulated by the rules on unjustified enrichment.

(3) The effect of avoidance under this Section on the ownership of property which has been transferred under the avoided contract is governed by the rules on the transfer of property.

COMMENTS

A. General effect

Avoidance has retrospective effect. It is distinct from termination, which has only prospective effect. Avoidance involves setting aside the contract, or the part of it avoided, as if it had not been made.

B. Personal right to restitution

The mutual restoration of benefits, or where the benefits themselves cannot be returned, their value, is a natural consequence of avoidance; it would not be right that avoidance should leave either party with a benefit at the other's expense. This is a clear case of unjustified enrichment. The rules on this matter are contained in Book VII. The general position is that the benefit obtained or retained by one party at the expense of the other as a result of avoidance will be an unjustified enrichment and that the disadvantaged party will have a right to have the enrichment reversed, either by the re-transfer of property (if that does not happen automatically, see below) or by a monetary equivalent, or monetary remuneration of services rendered.

C. Proprietary effects

The effect of avoidance on property is governed, in the case of movables, by Book VIII (Acquisition and Loss of Ownership in Movables). The general rule under that Book is that ownership does not pass under an avoided contract. The avoidance has retrospective proprietary effect. The property will be deemed never to have left the transferor. In the case of types of property not covered by that Book, the rules of the applicable law will govern.

II.-7:213: Partial avoidance

If a ground of avoidance under this Section affects only particular terms of a contract, the effect of an avoidance is limited to those terms unless, giving due consideration to all the circumstances of the case, it is unreasonable to uphold the remaining contract.

COMMENTS

A. Party wishes to avoid only part of the contract

The ground of avoidance may relate only to a particular term which the avoiding party wishes to avoid without affecting the remainder of the contract. The party should be permitted to do this.

Illustration 1

C takes a dress to be cleaned. She is asked to sign a contract limiting the cleaner's liability for any damage to the dress. She asks why she has to agree to this and is told that it is just to protect the cleaners if any of the sequins on the dress come off

in the cleaning. She signs. The dress comes back with a large stain on it and the cleaners try to rely on the clause. C may avoid the clause without avoiding the whole contract.

B. Appropriate to limit avoidance to part of contract

An incorrect statement or a mistake in communication may relate to a minor term of the contract. In such a case it may not be necessary or desirable to permit the party affected to avoid the whole contract if it is feasible to allow avoidance of the term involved and if this would not result in the contract being unbalanced in that party's favour.

Illustration 2

B, a building company, submits a bid for a major project. The total of its tender is made up of a number of items shown in the bid. There is clearly a mistake in one of these items, though it is not clear what the correct figure should be. The employer accepts the bid without pointing out the mistake. B may not avoid the whole contract but, on the assumption that the requirements of the rules on avoidance for mistake are satisfied, it can avoid the term fixing a mistaken price for the item in question. It will be paid a reasonable sum for the item.

Illustration 3

D buys a household insurance policy. Because the clauses of the contract are confusingly written he does not realise that the policy has an exclusion of any loss caused by theft which does not involve forcible entry. Such clauses are common in insurance policies of the type he is sold given that he lives in a high crime area; insurance against theft without forcible entry is much more expensive. D, on the assumption that the necessary requirements are satisfied, may avoid the whole contract and recover his premium but he cannot avoid just this exception, since the effect would be to give him "expensive" cover at a low price.

In some cases a mistake as to a single term may make it reasonable to avoid the whole contract. The burden of proving that it would be unreasonable to uphold the remainder of the contract is on the party who argues that it should be avoided as a whole.

One of the circumstances which is relevant is the behaviour of the party against whom avoidance is sought. In cases of fraud or duress, it may well be appropriate to allow the other party to avoid the whole contract if so wished.

II.-7:214: Damages for loss

(1) A party who has the right to avoid a contract under this Section (or who had such a right before it was lost by the effect of time limits or confirmation) is entitled, whether or not the contract is avoided, to damages from the other party for any loss suffered as a result of the mistake, fraud, coercion, threats or unfair exploitation, provided that the

other party knew or could reasonably be expected to have known of the ground for avoidance.

(2) The damages recoverable are such as to place the aggrieved party as nearly as possible in the position in which that party would have been if the contract had not been concluded, with the further limitation that, if the party does not avoid the contract, the damages are not to exceed the loss caused by the mistake, fraud, coercion, threats or unfair exploitation.

(3) In other respects the rules on damages for non-performance of a contractual obligation apply with any appropriate adaptation.

COMMENTS

A. Liability in damages

It is not sufficient that the party who has concluded a contract because of a mistake which the other party did not share, fraud, coercion, threats or unfair exploitation should only have a right to avoid the contract or part of it. First, the party may not wish to exercise the right of avoidance. In such a case it would be harsh to leave the party without any remedy, although that is the position under the laws of some Member States. The Article gives a right to damages.

Illustration 1

L tells the prospective tenant of a house that the drains are in good order. Relying on this the tenant signs the lease. They are not and the tenant becomes ill as a result. Whether L was fraudulent or merely careless, L should have to compensate the tenant.

Illustration 2

O employs P to build a house for it on a particular site. O knows that under the site there is an old sewer which is in danger of collapsing. It is obvious that P does not know this but O says nothing. One of P's lorries gets stuck when the sewer gives way under its weight and P has to pay a large sum to have it pulled out. O is liable for this cost.

It may be that on some facts the tenant in Illustration 1 would have a claim for non-performance of a contractual obligation. In this case the damages would include any higher cost involved in finding another house with drains which are in good order.

B. Measure of damages where contract avoided

Damages for non-performance of a contractual obligation aim to put the aggrieved party into the position it would have been in had the obligation been performed. In cases within this Section there has not been a non-performance, or at least not necessarily so: even in cases of fraud, the person making the statement is not necessarily giving a contractual undertaking that it is true. If there was no such undertaking, the untrue statement should not have caused any loss of expectation and the damages should not include an element

for this. The aim, when the contract is avoided, should be to put the party in the same position as if the contract had not been concluded.

Sometimes a statement which is made fraudulently, or which is incorrect, does also give rise to a contractual obligation. In this case the creditor in the obligation may choose between remedies under this chapter and remedies for non-performance of the obligation.

If the contract has been avoided and the aggrieved party suffered no consequential loss, there may be no further loss for which damages could be obtained under this Article.

Illustration 3

A leases a used car to B, fraudulently telling B that it has only done 20,000 km when in fact the odometer has been “clocked” and it has done 70,000 km. Because the car has covered such a great distance, a fair rental would be much less than B agreed to pay. Soon after he has taken delivery of the car, B discovers the truth and avoids the contract. His money is refunded. He has not suffered any further loss for which damages can be recovered under this Article, even if it costs him more to lease a car from another company.

“Loss” includes economic and non-economic loss. “Economic loss” includes loss of income or profit, burdens incurred and a reduction in the value of property. “Non-economic loss” includes pain and suffering and impairment of the quality of life. See Annex 1. It follows that damages under the Article may include compensation for opportunities which the party passed over in reliance on the contract.

Illustration 4

E accepts an offer of employment from F after F fraudulently tells her that the job carries an index-linked pension. E finds that the job does not have such a pension scheme and she avoids the contract. To take the job she had passed up another job offer at a much better salary than she can now get elsewhere. E may recover as damages the difference between what she would have earned in the other job and the salary she can now get.

C. Measure of damages where the contract is not avoided

A party who has the right to avoid the contract but does not do so, for instance because of a failure to act quickly enough to avoid the contract, should be able to recover damages. However, the party should not necessarily be put into the same position as if the contract had not been concluded. To allow this might permit the party to throw other losses, such as a decline in the value of the property, on to the other party, when that item of loss was in no way related to the ground for avoidance.

Illustration 5

A, a developer, buys a plot of land for €5 million, relying inter alia on a statement by the seller that the land is not subject to any rights in favour of third parties.

Later A finds that there is a right of way running across part of the site. This is serious enough to constitute a mistake which would justify avoidance of the contract but A decides not to avoid the contract. It will cost €10,000 to divert the path. Meanwhile, because of a slump in property prices, the value of the site has fallen from €5 million to €2.5 million. A's damages are limited to €10,000.

D. Cases where no fault

In cases of mistake as to the nature or circumstances of the obligation where the mistake was shared, there is not the same reason to make either party liable, except where one of them was at fault.

E. Contributed to own loss

Sometimes the victim of a fraud or mistake contributed to the loss suffered. In such a case the damages may be reduced. This is one the effects of applying the general rules on damages for non-performance of a contractual obligation except as modified in the Article.

II.-7:215: Exclusion or restriction of remedies

(1) Remedies for fraud, coercion, threats and unfair exploitation cannot be excluded or restricted.

(2) Remedies for mistake may be excluded or restricted unless the exclusion or restriction is contrary to good faith and fair dealing.

COMMENTS

Fraud, coercion, threats and unfair exploitation are of such seriousness that a party should not be able to exclude or restrict liability; they are all forms of bad faith.

Mistake does not involve bad faith and it is permissible to exclude or restrict remedies for mistake provided that the term doing so is consistent with good faith and fair dealing and not for instance, one which was hidden in small print or over which the party relying on it refused to negotiate.

The burden of proving that the clause is contrary to good faith and fair dealing should rest on the party seeking to avoid its effect.

This Article does not prevent a party agreeing to a settlement of a claim which in effect involves surrendering rights under this Section.

II.-7:216: Overlapping remedies

A party who is entitled to a remedy under this Section in circumstances which afford that party a remedy for non-performance may pursue either remedy.

COMMENTS

In some situations the same facts may be analysed either as a case of mistake, or as one in which there is a non-performance of a contractual obligation. For example there may be a remedy for non-performance because the performance of one party is not of the required quality; or one party may have given a contractual undertaking that a particular fact relating to the performance is true.

Although some systems prevent the aggrieved party from choosing which set of remedies to pursue in cases of this type, there seems no good reason to do so provided that there is no “double recovery” and the choice does not have the effect that a claim escapes contractual or other restrictions which should properly apply to it. Normally the remedies for non-performance will give a fuller measure of recovery, but the aggrieved party may find it simpler to exercise rights under this Section, e.g. just to give notice of avoidance on the ground of mistake.

Needless to say, the aggrieved party will still have to choose remedies which are compatible. It would not be possible, for example, both to avoid the contract and claim damages for non-performance of an obligation under it.

Section 3: Infringement of fundamental principles or mandatory rules

II.-7:301: Contracts infringing fundamental principles

A contract is void to the extent that:

- (a) it infringes a principle recognised as fundamental in the laws of the Member States of the European Union; and*
- (b) nullity is required to give effect to that principle.*

COMMENTS

A. Scope of section

This Section deals with the effects on a contract of infringement of fundamental principles or mandatory rules. Like the rest of the chapter it also applies, with appropriate adaptations, to other juridical acts. See the first Article of the Chapter. The subject matter is sometimes described as “illegality” and was so described in the Principles of European Contract Law, from which this Section is derived. However, “illegality” is not necessarily the most appropriate term for some infringements of fundamental principles or

mandatory rules. In some cases the contract may be immoral rather than illegal and in some cases it may just suffer from a defect of a rather formal or regulatory character. So the present title of the Section is descriptive and neutral.

B. Contrary to principles recognised as fundamental in the laws of the Member States

The formulation of the first Article is similarly intended to avoid the varying national concepts of immorality, illegality at common law, public policy, *ordre public* and *bonos mores*, by invoking a necessarily broad idea of fundamental principles found across the European Union, including EU law. Guidance as to these fundamental principles may be obtained from such documents as the EC Treaty (e.g. in favour of free movement of goods, services and persons, protection of market competition), the European Convention on Human Rights (e.g. prohibition of slavery and forced labour (art. 3), and rights to liberty (art. 5), respect for private and family life (art. 8), freedom of thought (art. 9), freedom of expression (art. 10), freedom of association (art. 11), right to marry (art. 12) and peaceful enjoyment of possessions (First Protocol, art. 1)) and the European Union Charter on Fundamental Rights (which includes many of the rights already mentioned and adds such matters as respect for personal data (art. 8), freedom to choose an occupation and right to engage in work (art. 15), freedom to conduct a business (art. 16), right to property (art. 17), equality between men and women (art. 23), children's rights (art. 24), rights of collective bargaining and action (art. 28), protection in the event of unjustified dismissal (art. 30), and a high level of consumer protection (art. 38).

Merely national concepts as such have no effect under the Article and may not be invoked directly, although comparative study can give further help in the identification and elucidation of principles recognised as fundamental in the laws of the Member States. Thus the Article extends to contracts placing undue restraints upon individual liberty (for example, being constraints of excessive duration or covenants not to compete), upon the right to work, or being otherwise in restraint of trade, contracts which are in conflict with the generally accepted norms of family life and sexual morality, and contracts which interfere with the due administration of justice (e.g. champertous agreements in England, *pacta de quota litis* elsewhere). See further *Kötz and Flessner* 155-161.

Many infringements of principles mentioned in the preceding paragraphs might not be such as to justify automatic nullity of the contract. Sub-paragraph (b) therefore provides that the contract will be void only to the extent that nullity is required to give effect to the fundamental principle.

The public policy underpinning principles recognised as fundamental may change over time, in accordance with the prevailing norms of society as they develop.

Situations covered by the rules on vices of consent or unfair contract terms fall outside the scope of the present Article.

C. Void

A contract which infringes fundamental principles, and the nullity of which is required by the Article, is void from the beginning and not merely voidable by a party or by a court. Unlike the position under the following Article, the judge or arbitrator is given no discretion to determine the effects of the contract: such a contract is to be given no effect at all. The intentions and knowledge of the parties are irrelevant.

II.-7:302: Contracts infringing mandatory rules

(1) Where a contract is not void under the preceding Article but infringes a mandatory rule of law, the effects of that infringement on the validity of 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 on the validity of a contract, a court may;

(a) declare the contract to be valid;

(b) avoid the contract, with retrospective effect, in whole or in part; or

(c) modify the contract or its effects.

(3) A decision reached under paragraph (2) should be an appropriate and proportional response to the infringement, having regard to all relevant circumstances, including:

(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 the infringement was intentional; and

(f) the closeness of the relationship between the infringement and the contract.

COMMENTS

A. General

Many contracts infringe a mandatory rule of law without being contrary to any fundamental principle. This Article deals with such contracts. If the infringement also involves a violation of a fundamental principle within the meaning of the preceding Article it is that Article which applies. In practice, therefore, the present Article deals with less important violations of the law. Indeed, given the extent of statutory regulation in modern States, some infringements covered by the Article may be of a merely technical nature. This means that a flexible approach has to be taken to the effects of an infringement.

B. Mandatory rules of the applicable law

The Article does not declare when a contract infringes a mandatory rule of law. Although the model rules constitute a self-contained system applying to contracts governed by them, it is not possible to ignore altogether the provisions of national and other positive laws otherwise applying to such contracts, in particular those rules or prohibitions

expressly or impliedly making contracts null, void, voidable, annulable, or unenforceable in particular circumstances. Where such rules are applicable to the contract the present Article is to be brought into play. The Article is however concerned only with the *effects* of the infringement.

C. Infringement

An infringement of a mandatory rule of law may arise in respect of who may conclude the contract, how it may be concluded, the contents or purpose of the contract, or (exceptionally) the performance of the contract.

The clearest case is where an applicable mandatory rule as to who may make certain contracts is infringed.

Illustration 1

A statute provides that a company may provide credit to consumers only if it holds a licence granted by the government, and that consumer credit agreements entered into by unlicensed providers are unenforceable by the provider. The unlicensed provider of consumer credit is also guilty of a criminal offence. Here the making of a consumer credit agreement by an unlicensed provider would infringe the rule of law.

More difficult is the issue of the contract with an illegal purpose. In general, for an illegal purpose to impact upon the effectiveness of the contract, it would seem that this must be the common purpose of the parties, at least in the sense that the illicit purpose of one is known to or ought to be known to the other.

If it is only the performance of the contractual obligation which infringes the mandatory rule, the contract itself may well be unaffected by the infringement. Thus if a haulier breaks the speed-limit from time to time, or jumps a stop light, while performing a contract for the carriage of goods by road the contract remains unaffected by the rules in this Article. The contract itself does not infringe the mandatory rules of the road traffic law. Only if it was intended by one or both parties from the outset that a contractual obligation be performed in an illegal manner do questions arise about whether and to what extent the contract is voidable. The situation is then similar to that of a contract with an illegal purpose.

Illustration 2

A buyer, who is in urgent need of the seller's goods, persuades the seller to promise to break the speed limit when bringing the goods. This promise by the seller is within the scope of the rules on illegality.

D. Effects of infringement

In determining the effects of an infringement upon a contract under this Article, regard is to be had first to what the mandatory rule in question provides upon the matter.

If the mandatory rule provides expressly for the effect of an infringement then that effect follows. If the relevant rule expressly states that infringement invalidates a contract, or if it provides that contracts are not to be invalidated by any infringement, then these consequences follow. For example, Article 81 of the EC Treaty prohibits agreements between undertakings which have as their object or effect the prevention, restriction or distortion of competition within the common market and declares such prohibited agreements to be “automatically void”. Conversely, the legislation may provide that the criminal offence which may be committed in the course of concluding a contract or performing an obligation under it does not of itself make the contract void or unenforceable or prevent any cause of action arising in respect of any loss (see e.g. UK Package Travel, Package Holidays and Package Tours Regulations 1992 reg. 27, implementing Council Directive 90/314/EEC on package travel, package holidays and package tours).

The rule in question may not provide expressly for the effects upon a contract of an infringement of the rule. It is necessary for the Article to deal with this second situation. It does so by making reference to a person (judge or arbitrator) with power to determine matters arising under the contract. If the matter is never referred to a judge or arbitrator (and is not within the preceding Article) then the contract is not affected by the infringement. Contracts are valid unless otherwise provided, and in this situation there is no Article or mandatory rule of law which provides for invalidity.

Where paragraph (2) is brought into operation, the judge or arbitrator is given a discretion to declare the contract to be valid, to avoid the contract with retrospective effect in whole or in part, or to modify the contract or its effects. The power to modify would include power to dispense with future performance of obligations under the contract but to let matters otherwise rest as they are, without any restitution. Equally, the contract may be given some but not complete future effect: for example, it may be made enforceable by one of the parties only, or only in part, or only at a particular time. It may be that some remedies, such as an order for specific performance, are not to be available, while others, such as damages for non-performance, are to be. The decision must be an appropriate and proportional response to the infringement having regard to all the relevant circumstances and, in particular, to those spelled out in paragraph (3).

E. Factors to be taken into account in determining effect of infringement

Paragraph (3) enjoins the judge or arbitrator to take into account all the relevant circumstances in determining the effect of the infringement of the law upon the contract. To assist in this process, a number of factors are listed. The list is not exclusive, and the factors mentioned may well overlap in application.

Purpose of the rule. Where the rule in question contains no express provision about the effect on the validity of a contract which infringes the rule, the legislative intent will have to be determined in accordance with the usual rules on the interpretation of the law. A

purposive approach is to be adopted. Consideration should always be given to whether, in the absence of an express statement on the point, enabling the rule to take full effect requires the contract to be set aside. Examples where the purpose of the legislation should be considered might include whether a piece of domestic legislation was intended to apply to a trans-national or cross-border transaction, or whether an international or European rule was to apply to a purely domestic transaction.

For whose protection does the rule exist? This factor is closely related to the issue of the purpose of the rule. If, for example, the rule in question merely prohibits one party from entering or making contracts of the kind in question, it does not follow that the other party may plead the illegality to prevent the contract taking effect.

Illustration 3

A statute lays down that domestic construction work is only to be carried out by registered builders, but does not say what effect the prohibition has upon contracts made by unregistered builders. 75% of a contract to build an extension to a private dwelling house is completed by an unregistered builder, who then abandons the job. If the court or arbitrator concludes that the main purpose of the rule is to protect clients then, while the client may not be able to insist on specific performance of the contract by the unregistered builder, the client may have a claim against the builder for damages in respect of defective work or the additional cost of having the work completed by a registered builder.

Illustration 4

In breach of companies legislation, a company agrees to provide financial assistance to shareholders to enable them to purchase more of the company's shares. The purpose of the legislation is the protection of shareholders and creditors of the company. The agreement may be upheld if all the shareholders in the company are purchasers and no creditors are adversely affected by the transaction.

Illustration 5

A consumer protection statute prohibits the negotiation or conclusion of loan agreements away from business premises. The aim of the statute is to protect consumers from 'cold selling' by home-visiting or telephoning salesmen of credit acting on behalf of consumer credit companies. While such companies are unable to enforce agreements entered in such circumstances, the consumer for whose protection the prohibition exists may do so.

Sanctions already incurred. If the rule in question provides for a criminal or administrative sanction against the wrongdoer, the imposition of that sanction may be enough to deter the conduct in question without adding the nullity of the contract. The goal of deterrence is usually better achieved through such criminal or administrative sanctions than by way of private law. Often such sanctions will take into account the degree of blameworthiness of the party concerned, and this may be a more appropriate response to the conduct than avoiding the contract in whole or in part.

Illustration 6

A statute provides that ships of a certain size must not carry cargoes above a certain quantity. Criminal sanctions are provided, but the statute says nothing about any civil consequences of infringement of the prohibition. A, a shipowner, contravenes the statute in carrying a cargo for B. B invokes the illegality of the performance and refuses to pay the freight. Because the aim of the statute is sufficiently fulfilled by the imposition of the criminal sanction upon A, the contract would be unlikely to be avoided by a court. B must pay the freight.

Illustration 7

Legislation prohibits court officials from engaging in remunerated activities outside their employment. The purposes of the rule are protection of the professional integrity of officials and deterring them from entering such arrangements, but this can be achieved by the application of disciplinary sanctions adjusted to take account of the degree of guilt, rather than by enabling the other party to the transaction to have the official's services for nothing.

Seriousness of the infringement. The judge or arbitrator is able to consider the seriousness of the infringement of the rule in assessing what if any effect it should have upon the contract. If the infringement is minor or very slight, that may point to the contract being declared valid and given effect.

Illustration 8

A shipowning company is in breach of statutory regulations as to the maximum load to be carried by ships but only by a very small amount. It should not be disabled on this ground alone from recovery of freight for the voyage.

If on the other hand the infringement had major or serious consequences that might suggest that there should be some effect upon the contract.

Was the infringement intentional? This enables the judge or arbitrator to take account of the knowledge or innocence of the parties with regard to the infringement of the rule. Subject to the other factors in the case, in particular the purpose of the law in issue, there is a stronger case for the infringement rendering the contract invalid if it was known to or intended by the parties than if both were unaware of the problem. More complex is the situation where one party knows of the infringement and the other does not, where much may depend upon which of them is trying to enforce the contract.

Illustration 9

A contract of carriage involves illegal performance of the obligations under it by the carrier, who is aware of the requirements of the law in question. The customer who is aware of the proposed illegality when the contract is concluded cannot sue for damages for non-performance of the contractual obligation by the carrier, unlike the customer who is not so aware. Whether or not the carrier can sue for

payment of the price under the contract once the obligations under it are fully performed may additionally depend upon factors such as the purpose of the prohibition and the other sanctions available, e.g. under the criminal law.

The most difficult situation is the contract for an illegal purpose. If it is lawful for A to sell a weapon or explosive material to B, and these materials may be lawfully used (for example, in self-defence or in construction work), the fact that B intends to use the goods illegally ought not to affect the validity of the contract of sale. If however at the time of contracting A is aware of or shares B's illicit purpose (e.g. supplies Semtex to a person whom A knows to be an active member of a terrorist organisation), then there may be some deterrence from entering the contract (on credit terms at least) if A cannot compel B to pay for material supplied.

Relationship between infringement and contract. This factor requires examination of whether or not the contract expressly or impliedly stipulates for an illegal performance by one or both of the parties. Thus a contract of carriage which can only be performed by overloading the ship or lorry may be more readily avoided by a court (although possibly the case might be addressed by an appropriate modification of the contract).

II.-7:303: Effects of nullity or avoidance

(1) The question whether either party has a right to the return of whatever has been transferred or supplied under a contract, or part of a contract, which is void or has been avoided under this Section, or a monetary equivalent, is regulated by the rules on unjustified enrichment.

(2) The effect of nullity or avoidance under this Section on the ownership of property which has been transferred under the void or avoided contract, or part of a contract, is governed by the rules on the transfer of property.

(3) This Article is subject to the powers of the court to modify the contract or its effects.

COMMENTS

A. Restitution

If the prohibitions and rules of other legal orders commonly fail to state the effect upon contracts that infringe their requirements, it is even more common for them to fail to state what are the remedial consequences of a finding of invalidity for the contract where one or both parties have commenced performance of the obligations under it. In general, for reasons ranging from deterrence, punishment or protection of the dignity of the courts to a notion that parties to an illegal or immoral transaction have placed themselves outside the legal order, the national systems of Europe have commenced their analysis of this problem from the traditional basis of Roman law, which denied restitution and left the parties in whatever position had been achieved at the time the invalidity was recognised (*ex turpi causa melior est conditio possidentis*). But restitution, or unwinding the

performances rendered under the illegal contract, appears to be a more appropriate response to the invalidity. The problems to which denial of restitution can lead, namely leaving the effects of the invalidity standing, may be illustrated by the following example:

Illustration 1

A statute declares that any contract using an abolished system of weights and measures is to be void. A sells goods to B in a contract using the abolished system of weights and measures to determine the quantity of goods to be delivered and the price. B, having taken delivery and consumed the goods, refuses to pay. If A has no action for the contract price, denial of restitution would allow B to have the benefit of the infringing transaction without paying for it.

This Article therefore recognises in principle that restitution of performances rendered under the invalid contract may be available but refers to the rules on unjustified enrichment for the detailed rules.

Similarly, the Article refers to the law on the transfer of property for the proprietary effects of a contract which is void or avoided under this Section. In cases of transfer of movables regulated by the later Book on that subject the effect is that there will normally be no effective transfer of the property. The nullity or avoidance has retrospective proprietary effect. The property will remain in the ownership of the party who owned it before it was transferred under the void or avoided contract.

The rules here are the same as in Section 2 of this chapter but their effect may be modified by the powers of the court to modify a contract, or the effects of a contract, which infringes mandatory rules.

II.-7:304: Damages for loss

(1) A party to a contract which is void or avoided, in whole or in part, under this Section is entitled to damages from the other party for any loss suffered as a result of the invalidity, provided that the first party did not know and could not reasonably be expected to have known, and the other party knew or could reasonably be expected to have known, of the infringement.

(2) The damages recoverable are such as to place the aggrieved party as nearly as possible in the position in which that party would have been if the contract had not been concluded or the infringing term had not been included.

COMMENTS

Restitution will not be possible in every case, since benefits will not necessarily have been transferred between the parties when the invalidity takes effect; yet one of the parties may be unfairly out of pocket as a result of concluding the invalid contract. Not

every law has in the past provided a remedy in such a case and, in the case of an unlawful competitive agreement, the ECJ has said that a remedy in damages against the other party to the illegal agreement should be provided. (*Courage Ltd v Crehan* [2001] All ER (EC) 886; and see the Advocate General's opinion at para 41). The Article accordingly provides for a right to damages. It would be inappropriate for the damages to extend to the positive or expectation interest of the party, since putting the party in the same position as if the obligations under the contract had been performed would be to enforce the invalid contract. The aim of the damages should therefore be to place the aggrieved party in the same position as if the contract had not been concluded. A party who knows or ought to have known of the infringement cannot, however, recover damages.

Illustration

Legislation requires the suppliers of certain chemicals to hold licences indicating compliance with safety and environmental standards. Contracts made by suppliers holding no licence are declared to be null. Company A, which has recently been deprived of its licence by government action, nevertheless concludes a contract for the supply of the chemicals to Company B, which is unaware of A's fall from grace and buys from it because its price is lower than that of the only other licensed supplier, C. B intends to use the chemicals for industrial purposes leading on to profitable contracts of its own, and spends money preparing its premises to handle the material safely. A's illegal conduct is discovered and the contract with B is declared null before either delivery or payment have taken place. B is unable to make the intended further contracts. While B cannot recover the expectation loss of profit on these further contracts, it may recover its incidental reliance expenditure on preparing its premises and any other costs associated with having contracted with A. These might include a figure for the loss of the opportunity to contract with C (as distinct from the extra cost of contracting with C or the profits which would have been earned had B concluded the contract with C rather than A).

The solution here is similar to that adopted for avoidance for a vice of consent under Section 2.

CHAPTER 8: INTERPRETATION

Section 1: Interpretation of contracts

II.-8:101: General rules

(1) A contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words.

(2) If one party intended the contract, or a term or expression used in it, to have a particular meaning, and at the time of the conclusion of the contract the other party was

aware, or could reasonably be expected to have been aware, of the first party's intention, the contract is to be interpreted in the way intended by the first party.

(3) The contract is, however, to be interpreted according to the meaning which a reasonable person would give to it:

(a) if an intention cannot be established under the preceding paragraphs; or

(b) if the question arises with a person, not being a party to the contract or a person who by law has no better rights than such a party, who has reasonably and in good faith relied on the contract's apparent meaning.

COMMENTS

A. General

Contracts are interpreted in order to determine their contents. This is particularly the case when the contract contains a term which is ambiguous, obscure or vague; that is, when one cannot immediately see the exact meaning. But interpretation will also be necessary if terms which seem clear enough in themselves contradict each other, or cease to be clear when the general setting of the contract is taken into account.

When a contract contains gaps which need to be filled, the process is sometimes referred to as completive interpretation (*ergänzande Auslegung*) or the addition of implied terms. This is covered in II.-9:101 (Terms of a contract).

Determining the exact meaning of the contract may be necessary before it can be determined whether the contract is valid or whether there has been a non-performance. For example, it may be necessary to decide whether the debtor's obligation was one to produce a particular result (*obligation de résultat*) or only one to use reasonable care and skill (*obligation de moyens*).

Any kind of contract may need interpretation, from a very formal contract drawn up by, and concluded in the presence of, a notary to a very informal contract concluded orally. Similarly, the rules of interpretation apply to contracts made on standard forms. In fact some of the rules apply particularly to these types of contract. Interpretation may be needed for the whole or part of a contract and for any term or expression used in it. And it may be needed for non-verbal expressions of intention such as symbols, signs or gestures.

It is not only judges who are called on to interpret contracts. Indeed one of the functions of rules of interpretation is to enable the parties and their advisers to apply the rules and arrive at an agreed interpretation in the light of them, thus possibly avoiding the need for litigation.

B. The search for common intention

Following the majority of laws of EU Member States, the general rules on interpretation combine the subjective method, according to which pre-eminence is given to the common

intention of the parties, and the objective method which takes an external view by reference to objective criteria such as reasonableness, good faith etc. The person interpreting the contract (the “interpreter”) is thus encouraged to start by looking to see what was the parties’ common intention at the time the contract was made. This is normal because the contract is primarily the creation of the parties and the interpreter should respect their intentions, expressed or implicit, even if their will was expressed obscurely or ambiguously. One of the clearest cases for the application of the rule in paragraph (1) is where the parties have, perhaps for reasons of commercial secrecy, deliberately used code words in contracting.

In seeking this common intention the interpreter should pay particular attention to the relevant circumstances as set out in the next Article.

There may be a common intention of the parties even in the case of a contract of adhesion, in so far as the party who was not responsible for drafting the contract had a sufficient knowledge of the clauses and adhered to them.

The search for common intention is compatible with rules which forbid the proof of matters in addition or contrary to a writing, for example if the parties have negotiated a merger clause to the effect that the writing contains all the terms of the contract, as it refers to external elements only to clarify the meaning of a clause, not to contradict it.

The Article states another important point: the interpreter should give effect to the common intention of the parties over the letter of the contract. This means that in a case of conflict between the words written and the common intention, it is the latter which must prevail. Thus if a document is described as a loan but its content indicates that it is really a lease, the interpreter should not attach importance to the description in the document.

Illustration 1

The owner of a large building employs a painting firm to repaint the “Exterior window frames”. The painters repaint the outside of the frames of the exterior windows and claim that they have finished the job; the owner claims that the inside surfaces of the frames to exterior windows should also have been painted. It is proved by the preliminary documents that the representatives of the owner and of the painting firm who negotiated the contract had clearly contemplated both surfaces being done. Although the normal interpretation might suggest that only the outside surfaces were within the contract, since exterior and interior decoration are usually done separately, the parties’ common intention should prevail.

All the same, the interpreter must not, under the guise of interpretation, modify the clear and precise meaning of the contract where there is nothing to indicate that this is required by the Article. This would be to ignore the principle of the binding force of contract.

C. Party knows the real intention of the other party

If one party's words do not accurately express that party's intention, for instance because the intention is expressed wrongly or the wrong words are used, the other party can normally rely on the reasonable meaning of the first party's words. But this is not the case if the second party knew or could reasonably be expected to have known of the first party's actual intention. If the second party concludes the contract without pointing out the problem the first party's intended interpretation should be binding.

Illustration 2

A, a fur trader, offers to sell B, another fur trader, hare skins at so much per kilo; this is a typing error for so much a piece. In the trade, skins are usually sold by the piece and, as there are about six skins to the kilo, the stated price is absurdly low. B knows or could reasonably be expected to know what A really meant but nonetheless purports to accept. There is a contract at the stated price per piece as A intended.

One may see in this rule also a consequence of the rule that the intention of the parties prevails over the letter of the contract.

D. Objective method

The interpreter should not try to discover the intentions of the parties at any price and end up deciding what they were in an arbitrary way. When a common intention cannot be discerned, and paragraph (2) of the Article does not apply, paragraph (3) comes into operation. This refers not to fictitious intentions but to the meaning which a reasonable person would have given to the contract. A reasonable person would, of course, take into account the objective circumstances in which the contract was concluded and the nature of the parties between whom it was concluded. This provision will be of very wide application because in practice it is quite common for parties to have no special intention as to the meaning of expressions used in their contract. But equally this use of objective interpretation does not empower the judge to overturn the contract under the guise of interpretation and to go against the unequivocal will of the parties.

Paragraph (3) also applies in a question with a third party who has reasonably and in good faith relied on the apparent objective meaning of the contract. Third parties who rely, reasonably and in good faith, on the apparent meaning of contracts cannot be expected to be bound by special meanings secretly attached to terms or expressions by the parties. Paragraph (3) provides protection for third parties in this type of case. It will be remembered also that many contracts of a type which are intended from the outset to be relied on by third parties (such as negotiable instruments and contracts registered in a land register) are outwith the scope of the model rules and will be regulated by special rules.

However, paragraph (3) preserves the rule that an assignee has no better right against the other party to the original contract than the assignor. An assignee has to take many risks, including the risk that a contract has been modified by agreement between the parties

since it was concluded, and has appropriate rights against the assignor who conceals the existence of defences or exceptions available to the other party to the contract. To allow an assignee to take advantage of the apparent meaning of a term, when its real meaning as between the parties was something else, would be to allow one party to a contract to cheat the other party by the simple expedient of an assignment. This would be contrary to the requirements of good faith and fair dealing. Of course, if the other party to the contract participated in a fraud on the assignee there would also be delictual remedies against that party based on the fraud.

II.-8:102: Relevant matters

- (1) In interpreting the contract, regard may be had, in particular, to:*
- (a) the circumstances in which it was concluded, including the preliminary negotiations;*
 - (b) the conduct of the parties, even subsequent to the conclusion of the contract;*
 - (c) the interpretation which has already been given by the parties to terms or expressions which are the same as, or similar to, those used in the contract and the practices they have established between themselves;*
 - (d) the meaning commonly given to such terms or expressions in the branch of activity concerned and the interpretation such terms or expressions may already have received;*
 - (e) the nature and purpose of the contract;*
 - (f) usages; and*
 - (g) good faith and fair dealing.*
- (2) In a question with a person, not being a party to the contract or a person such as an assignee who by law has no better rights than such a party, who has reasonably and in good faith relied on the contract's apparent meaning, regard may be had to the circumstances mentioned in sub-paragraphs (a) to (c) above only to the extent that those circumstances were known to, or could reasonably be expected to have been known to, that person.*

COMMENTS

A. Relevant matters

Paragraph (1) of the Article gives the interpreter a non-exhaustive list of matters which may be relevant in determining either the common intention of the parties or the reasonable meaning of the contract.

Thus the interpreter may consider the preliminary negotiations between the parties (paragraph (a)): for example, one of the parties may have defined a term in a letter and the other not have contested this interpretation when an opportunity arose. The interpreter may do this even where the parties have agreed that the written document embodies the entirety of their contract (merger clause), unless in an individually negotiated clause the parties have agreed that anterior negotiations may not be used even for purpose of

interpretation. This sort of clause may be very useful when long and complicated negotiations were necessary for the contract.

The conduct of the parties, even after the making of the contract, may also provide indications as to the meaning of the contract (paragraph (b)).

Illustration 1

A German manufacturer of office supplies has engaged B to represent A in the north of France. The contract is for six years but the contractual relationship may be terminated without notice if B commits a serious non-performance of its obligations. One of these obligations is to visit each of the 20 universities in the area “every month”. Assuming that this obligation applies only to the months, in the country concerned, when the universities are open and not to the vacations, B only visits each one 11 times a year, and A knows this from the accounts which are submitted to it by B. After 4 years A purports to terminate the contractual relationship for serious non-performance by B of B’s obligations. Its behaviour during the four years since the conclusion of the contract leads to the interpretation that the phrase “every month” must be interpreted as applying only to the months when universities are active.

Not all the laws of the Member States allow evidence to be given of pre-contractual negotiations, on the grounds that what one party said was meant is not useful evidence as the other might not have agreed with the interpretation. A better approach is not to exclude the evidence but to allow the court to assess it for what it is worth. Similarly with subsequent conduct.

The practices established between the parties (paragraph (c)) are often decisive.

Illustration 2

A has made a franchise contract with B. A clause provides that B is to pay within ten days for goods received from A. For a three month period B pays within 10 working days. Then A demands payment within ten days including holidays. The practice adopted by the parties indicates that this is not a correct interpretation.

The reference (paragraph (c)) to the interpretation which has already been given by the parties to terms or expressions which are the same as, or similar to, those used in the contract is particularly relevant in relation to standard terms.

Paragraph (d) (concluding words) extends the same idea to terms or expressions which have already been the subject of interpretation by courts. This obviously may inform the interpreter’s decision. The meaning generally given to terms and expressions in a particular sector may also be useful when one is dealing with terms which have a technical meaning different to their ordinary meaning, for example the “dozen” which is understood in a particular trade to mean thirteen (the “baker’s dozen”).

The nature and the purpose of the contract may also be considered (letter (e)).

Illustration 3

The manager of a large real estate development makes a fixed price contract with a gardening company for the maintenance of the "green spaces". The manager later complains that A has not repaired the boundary wall. The contract cannot be interpreted as covering this as it is a contract for gardening.

Furthermore, it is normal to refer to usages whether the parties may be considered to have contracted with reference to them or whether these usages form the basis of a reasonable interpretation used to resolve an uncertainty in the meaning of the contract.

The Article refers in principle to usages which are current at the place the contract is made, although there may be difficulty in establishing this place.

Illustration 4

A wine merchant from Hamburg buys 2,000 barrels of Beaujolais Villages from a co-operative cellar B. In Beaujolais a barrel contains 216 litres, whereas a Burgundian barrel contains more. A cannot claim that the barrels referred to in the contract are Burgundian barrels.

Illustration 5

A film producer A and a distributor B make a distribution contract in which there is a clause providing for payment of a certain sum if the number of exclusive screenings (i.e. screenings only in a single cinema or chain of cinemas) is less than 300,000. A meant exclusive for the whole of France, B only for the Paris region. According to usages of the French film industry, exclusivity means exclusivity only in the Paris region. It is this meaning which applies.

Finally, good faith and fair dealing will often determine the interpretation of the contract.

B. Third parties

In a question with third parties, where an objective interpretation is adopted, it would be unreasonable to refer to circumstances such as the negotiations or the subsequent conduct of the parties unless the third party knew of them or could reasonably be expected to have known of them. This is provided for by paragraph (2).

II.-8:103: Interpretation against party supplying term

Where there is doubt about the meaning of a contract term not individually negotiated, an interpretation of the term against the party who supplied it is to be preferred.

COMMENTS

This rule, often called the *contra proferentem* rule, is widely recognised both in legislation and above all in case law in the different national and international laws. It rests on the idea that the party who has drafted a clause, or the whole contract, unilaterally should normally bear the risk of any defect in the drafting. The rule applies not only against the author but also against anyone who uses pre-drafted clauses. This will be the case when the clauses have been prepared by a third party, for example the professional association to which the party employing the clauses belongs.

It applies in particular to standard terms drawn up unilaterally by one party, but it may also apply to a contract of adhesion which has been drawn up for the particular occasion but which is non-negotiable.

Illustration

An insurance contract contains a clause excluding losses caused by “floods”. The insurance company which drafted the contract cannot maintain that this exclusion applies to damage caused by water escaping from a burst pipe, since it has not made this clear.

It should be noted that the Article states only that the interpretation against the party who supplied the term “is to be preferred”. An interpreter could, in appropriate circumstances, interpret a clause which has not been individually negotiated in favour of the party who proposed it.

II.-8:104: Preference for negotiated terms

Terms which have been individually negotiated take preference over those which have not.

COMMENTS

If in an otherwise non-negotiable contract (standard form or otherwise) there is, exceptionally, a term which has been negotiated, it is reasonable to suppose that this term will represent the common intention of the parties, other indications apart. This rule complements the rule in the preceding Article.

The preference given to negotiated terms applies also to modifications made to a printed contract, whether by hand or in any other way (e.g. typed or stamped on). One may in effect assume that these modifications were negotiated. However, it is a rebuttable presumption.

Illustration

A printed form is used for the conclusion of an option to purchase land. One of the clauses provides that the eventual buyer will deposit a cheque for 10% of the price with an intermediary until the option is either taken up or is refused. The parties agree to replace the requirement for a cheque with a bank guarantee. The intermediary writes this change on the margin of the document but omits to cross out the printed clause. The contradiction between the two clauses is to be resolved in favour of the hand-written clause.

The rule applies even if the modification was oral.

II.-8:105: Reference to contract as a whole

Terms and expressions are to be interpreted in the light of the whole contract in which they appear.

COMMENTS

It is reasonable to assume that the parties meant to express themselves coherently. It is thus necessary to interpret the contract as a whole and not to isolate clauses from each other and read them out of context. It must be presumed that the terminology will be coherent; in principle, the same word or expression should not be understood to have different meanings in different parts of the same contract. The contract must be interpreted in a way that gives it basic coherence, so that the clauses do not contradict each other.

There is normally no particular hierarchy between the elements of a contract, save under special circumstances: for example, particular emphasis should be given to any definition of terms or to a preamble which could have been introduced into the contract.

This Article may also be applied to groups of contracts. For example one can treat a frame-work (master) contract and the various contracts made under it as a whole. By the “whole contract” must be understood the “whole group of contracts”.

Illustration

Miss A, an inexperienced singer, is taken on for six months by B, the manager of a cabaret on the Champs-Élysées. The contract contains a clause authorising the manager to end the contract in the first three days of the singer starting work. Another clause allows either party to determine the contract on payment of a significant sum of money as a penalty. Miss A is fired after one day and claims payment of the sum. Her claim should fail because the penalty clause is to be read in the light of the clause allowing determination within three days, which is a trial period.

II.–8:106: Preference for interpretation which gives terms effect

An interpretation which renders the terms of the contract lawful, or effective, is to be preferred to one which would not.

COMMENTS

The parties must be treated as sensible persons who intended that their contract should be fully effective (*magis ut res valeat quam pereat*). Thus if a term is ambiguous and could be interpreted in one way which would make it invalid or another which would make it valid, the latter interpretation should prevail (*favor negotii*).

Illustration 1

Architect A assigns his practice to architect B and undertakes not to exercise his profession for five years “in the region”. If region is interpreted to mean the administrative region which contains several departments, the clause would be invalid as too wide. If region is interpreted in a less technical and more reasonable sense (a reasonable area) the clause will be valid and fully effective.

For identical reasons, if one of two possible interpretations would lead to an absurd result the other must be taken.

Illustration 2

A grants B a licence to produce pipes by a patented method. B must pay a royalty of €500 per 100 metres if annual production is less than 500,000 metres and €300 if it is over 500,000 metres. To calculate the royalties on 600,000 metres, one can interpret the clause as fixing the price at €500 per metre for the first 500,000 metres and €300 per metre for the remainder, or the rate of €300 per metre could be applied to the whole quantity. The latter interpretation is not valid because it leads to an absurd result: the royalty for a production of 600,000 m. would be less than that for 400,000 m.

II.–8:107: Linguistic discrepancies

Where a contract document is in two or more language versions none of which is stated to be authoritative, there is, in case of discrepancy between the versions, a preference for the interpretation according to the version in which the contract was originally drawn up.

COMMENTS

International contracts are sometimes drafted in more than one language and there may be divergences between the different linguistic versions. The parties may provide a solution by stating that one version is to be authoritative, in which case that version will

prevail. If nothing is provided and it is not possible to eliminate the divergences by other means (e.g. by correcting obvious errors of translation in one version), the present Article gives a reasonable solution by providing that the original version is to be treated as the authoritative one, since it is likely to express best the common intention of the parties.

Illustration

A French business and a German business make a contract in French and in German. The contract contains an arbitration clause. The French text provides that the arbitrator "*s'inspire*" from the rules of the ICC, i.e. may follow them. The German version provides "*er folgt*", i.e. the arbitrator must follow the ICC rules. The French version was the original and this is the one which should prevail.

If the contract provides that the different versions are to be equally authoritative, the will of the parties must be respected by observing this and resorting to the general rules of interpretation. It is not possible simply to give precedence to one version. It must be decided which version corresponds better to the common intention of the parties or, if this cannot be established, what reasonable persons would understand.

It is important to read this provision along with the *contra proferentem* rule if the original version was drafted by one of the parties.

Section 2: Interpretation of other juridical acts

II.–8:201: General rules

(1) A unilateral juridical act is to be interpreted in the way in which it could reasonably be expected to be understood by the person to whom it is addressed.

(2) If the person making the juridical act intended the act, or a term or expression used in it, to have a particular meaning, and at the time of the act the person to whom it was addressed was aware, or could reasonably be expected to have been aware, of the first person's intention, the act is to be interpreted in the way intended by the first person.

(3) The act is, however, to be interpreted according to the meaning which a reasonable person would give to it:

(a) if neither paragraph (1) nor paragraph (2) applies; or

(b) if the question arises with a person, not being the addressee or a person who by law has no better rights than the addressee, who has reasonably and in good faith relied on the contract's apparent meaning.

COMMENTS

A. General

The rules on the interpretation of contracts cannot all be applied directly to the interpretation of unilateral juridical acts. The primary rule in the interpretation of contracts refers to the common intention of the parties. That in itself introduces an element of objectivity. The “common intention” is not the same as secret uncommunicated individual intentions, even if they happen to be identical.

B. Reliance interest

Although some systems appear in principle to take a subjective approach, it seems inappropriate to interpret a unilateral juridical act according to the subjective intention of the maker. A person could not be allowed to say that he or she meant something entirely different to the ordinary meaning of the expressions used and expect this secret subjective meaning to have a legal effect on other people. So paragraph (1) lays down the general rule that a unilateral juridical act is to be interpreted in the way in which it could reasonably be expected to be understood by the person to whom it is addressed. This does not allow the subjective meaning placed on the act by the recipient to govern. That would be just as unreasonable as giving preference to the subjective intention of the maker of the act. However, it does allow account to be taken of the characteristics of the recipient. For example, a notice given by one trader to another trader in the same line of business would be interpreted as a trader in that line of business could be expected to interpret it, not as an ordinary citizen might be expected to interpret it. Paragraph (1) reflects the policy that a person receiving a communication which is intended to have legal effect is entitled to rely on its having the meaning which any recipient of the same type could reasonably be expected to place on it. The recipient is not at the mercy of the secret intentions of the sender; and the sender is not at the mercy of any unreasonable interpretation placed on the act by the recipient.

C. Recipient knows real intention of maker

Paragraph (2) of the Article is very similar to the equivalent provision for the interpretation of contracts and reflects the same policy. It clarifies a point which might have been unclear if paragraph (1) were left to apply on its own. It can be regarded as a particular application of the requirement of good faith and fair dealing. It would be contrary to good faith for a person who knows that the maker of an act attached a particular meaning to an expression, and who does nothing to indicate that this is not acceptable, to argue later that this meaning was different to the meaning which the recipient could reasonably be expected to give to the expression in other circumstances. The same applies if the recipient could reasonably be expected to know the particular meaning which the maker attached to the act or to any expression in it. In such circumstances the act is to be interpreted in the way intended by the maker.

D. Objective interpretation for all other cases

If neither paragraph (1) nor paragraph (2) applies, the act is to be interpreted according to the meaning that a reasonable person relying on the act would give to it in the

circumstances. In most cases this rule will produce the same results as paragraph (1) but the rule is necessary to cover cases where there is no identifiable addressee – for example, cases of offers addressed to the public.

This rule of objective interpretation also applies in a question with any person, not being the person to whom the act was addressed, who has reasonably and in good faith relied on its apparent meaning. Again, however, the rule that an assignee has no greater rights than the assignor is preserved.

II.–8:202: Application of other rules by analogy

The provisions of Section 1, apart from its first Article, apply with appropriate adaptations to the interpretation of a juridical act other than a contract.

COMMENTS

Application by analogy of other rules on interpretation of contracts

The preceding Article replaces only the first Article of Section 1 on the interpretation of contracts. The other Articles of Section 1 apply with appropriate adaptations. For example, references to the parties to the contract in Section 1 might have to be read as references to the person making the juridical act and the person to whom it is addressed. The references to negotiations would not always apply to unilateral juridical acts but might do so. For example, the scope of the authority to be granted to an agent might have been the subject of negotiations even if the eventual grant of authority was done by a unilateral act of the principal.

CHAPTER 9: CONTENTS AND EFFECTS OF CONTRACTS

Section 1: Contents

II.–9:101: Terms of a contract

(1) The terms of a contract may be derived from the express or tacit agreement of the parties, from rules of law or from practices established between the parties or usages.

(2) Where it is necessary to provide for a matter which the parties have not foreseen or provided for, a court may imply an additional term, having regard in particular to:

- (a) the nature and purpose of the contract;*
- (b) the circumstances in which the contract was concluded; and*
- (c) the requirements of good faith and fair dealing.*

(3) Any term implied under paragraph (2) should, where possible, be such as to give effect to what the parties, had they provided for the matter, would probably have agreed.

(4) Paragraph (2) does not apply if the parties have deliberately left a matter unprovided for, accepting the consequences of so doing.

COMMENTS

A. Sources of contract terms

The terms of a contract are not only those expressly agreed by the parties. They may also include terms only tacitly agreed by the parties, terms supplied by law and terms supplied by usages or practices. In most cases those sources will supply all the terms necessary. Exceptionally, however, even those terms may leave a gap caused by some unforeseen contingency which has not been provided for. Paragraph (2) enables a court to imply an additional term in such exceptional circumstances, having regard in particular to the nature and purpose of the contract, the circumstances in which it was entered into and the requirements of good faith and fair dealing. Such implied terms may impose additional obligations but they need not be limited to the imposition of additional obligations. They may, for example, affect the circumstances or manner in which existing obligations have to be performed in unforeseen circumstances.

B. Express agreement of the parties

This is the most obvious and normal source of the terms of a contract, particularly in the case of more formal contracts. The terms need not all be recited or set out at length. They may be imported by reference to other terms such as, for example, standard terms drawn up by trade associations or similar bodies.

C. Tacit agreement of the parties

There are many everyday contracts where expressly agreed terms are of a minimal nature and where a great deal depends on tacit agreement. For example, in a contract for the purchase of a newspaper from a newsagent only the name of the newspaper may be spoken but there will normally be a tacit agreement that the newspaper to be supplied will be the current edition and not yesterday's or last week's and that the price payable will be the price marked on it. In a contract with a licensed taxi driver the only express term may be the destination but there will normally be a tacit agreement that the driver will follow a more or less direct route to the destination and that the fare payable will be that shown on the meter.

The distinction between terms based on tacit agreement and terms implied by a court under paragraph (2) is that there is nothing exceptional about the first category. Indeed the reverse is true. The matters which any reasonable observer would say had been tacitly agreed will be matters which are so ordinary and so obvious that they are simply taken for granted.

There are no restrictions on the ascertainment of what the parties tacitly agreed. In deciding what may be held as tacitly agreed regard may be had to any relevant circumstances. II.-8.102 (Relevant matters) on matters relevant to the interpretation of contracts may provide some guidance here. The factors mentioned there include – the circumstances in which the contract was concluded; the conduct of the parties, even subsequent to the conclusion of the contract; the nature and purpose of the contract; the practices the parties have established between themselves (which may, however, also bind the parties directly, as noted below); usages; and good faith and fair dealing. There is an overlap between the ascertainment of tacit agreement and the interpretation of expressions used in concluding the contract and also with the effect of usages or practices, but there are cases where the tacit agreement route will be the most obvious way to a conclusion. It can be difficult or artificial, for example, to use the interpretation route if no words or other expressions are used by the parties. And there are cases where tacit agreement is so obvious that it is unnecessary to investigate the question of usages or practices.

D. Terms derived from other legal rules

Several of the provisions in these rules help to determine the terms of the contract where matters are not fully regulated by express terms or by usages or practices. Some of these deal with specific types of contract. Others, however, deal with general issues which do not depend on the nature of the contract and which may arise in many types of contract: e.g. the price, the quality of what is to be supplied or provided under the contract and what is to happen if an agreed mechanism for determining the price or some other term fails. It is not only the present rules which may supply a term in the absence of express regulation in the contract. There may be national or other laws which apply to the contract and which supply a term or terms.

E. Usages and practices

These are an important source of implied terms in their own right, quite apart from their role in ascertaining the tacit agreement of the parties. It will be remembered that Article II.-1:104 (Usages and practices) provides that:

- (1) The parties to a contract are bound by any usage to which they have agreed and by any practice they have established between themselves.
- (2) The parties are bound by a usage which would be considered generally applicable by persons in the same situation as the parties, except where the application of such usage would be unreasonable.

F. Filling gaps

Even when all the possible sources of terms listed in paragraph (1) are taken into account there may be cases where there is an obvious gap in the contract. There may be some matter which the parties simply did not foresee or provide for and where it would be unrealistic to assert that there was any tacit agreement. There may simply have been no agreement at all on the matter, express or tacit, and there may be no rule of law, usage or practice to provide a solution. In such circumstances paragraph (2) allows a court to imply an additional term, having regard in particular to the nature and purpose of the

contract, the circumstances in which it was concluded and the requirements of good faith and fair dealing. The additional term need not be an independent term: it may be a term which is dependent on, and adjusts the effect of, an existing term. The reference to the court does not, of course, mean that the parties have to resort to litigation to resolve every unforeseen contingency. It is always open to them to modify or supplement the terms of their contract by agreement.

G. Exceptional nature of the power

Because of the danger of giving courts too much power to rewrite contracts according to their own ideas of what the parties should have provided, paragraph (2) limits this power to cases where it is necessary to provide for a matter which was not foreseen or provided for by the parties. The word “necessary” serves two functions. First it makes it clear that the power under paragraph (2) cannot be exercised if the matter is already regulated by a term derived from any of the sources mentioned in paragraph (1). Secondly, it indicates that the court should not exercise its power merely to “improve” the operation of the contract. It will be for the court to decide whether an additional term is necessary, having regard in particular to the factors mentioned in paragraph (2). One criterion will be whether the contract would be workable without the term but that is not an exclusive criterion. There may be cases where the contract as a whole would be workable after a fashion without the additional term but where some particular aspect of it is unregulated and where the lack of regulation causes an obvious problem or gross distortion in the balance of the contract.

The extent to which gaps in the parties’ agreed terms are likely to be already filled by rules of law, usages or practices, and the fact that the parties can always agree to modify or supplement the terms of their contract, means that resort to paragraph (2) is likely to be unusual. This can be illustrated by the sort of fact situation which occurred in the classic English case on implied terms (*The Moorcock* (1899) 14 P.D. 64).

Illustration

A ship-owner contracted to unload the ship alongside a wharf in the Thames, where at low tide the ship will rest on the river-bed. The state of the river-bed was unknown to the ship-owner. In fact there was a ridge of rock across it which damaged the ship. The wharfinger was held to be under an implied obligation to warn the ship-owner of the danger.

Under these rules a more direct route to the same result is provided by the Article on the obligation to co-operate to give effect to the contract. There would be no need to resort to the exceptional power to imply an additional term in order to impose such an obligation. It should also be noted that the rules on service contracts provide expressly for certain obligations to inform.

H. The nature and purpose of the contract

The reference to the nature and purpose of the contract allows consideration to be given to how the contract can best be carried out if there are gaps in the terms agreed by the

parties or supplied by the law or by usages and practices. Considerable guidance may be obtained by looking at terms usually contained in similar contracts, or laid down in international conventions dealing with analogous contracts.

I. The circumstances in which the contract was concluded

The circumstances in which the contract was concluded, including the negotiations, may provide a good indication of what the parties would probably have agreed had they foreseen and provided for the contingency which has arisen.

J. Good faith and fair dealing

The reference to the requirements of good faith and fair dealing allows a court, in exercising its limited gap-filling function under paragraph (2), to look in an objective fashion at what good faith and fair dealing would require. If the matter which has not been provided for would pose an unacceptable risk for one party unless a term is implied to give that party some protection, a suitable term may be implied.

K. The probable intention of the parties

Paragraph (3) provides that any term implied under paragraph (2) should, where possible, be such as the parties, had they provided for the matter, would probably have agreed. In some cases there may be evidence which would enable the probable agreement of the parties to be determined with some confidence. For example, the parties may have consistently rejected one type of solution and consistently opted for another type of solution in relation to a range of foreseen problems. In such circumstances it might be reasonable to conclude that they would probably have applied the same approach to an unforeseen problem. In other cases the assessment of what the parties would probably have agreed will have to be based on more general considerations. For example, it would usually be justifiable to assume that the parties would have wished the contract to be carried out in a way which is fair, reasonable and practicable. The words “where possible” are inserted to provide for the situation where it is not possible to reach any conclusion about what the parties would probably have agreed within a range of fair, reasonable and practicable solutions but where it is still necessary to imply an additional term to give effect to the contract.

L. Matter deliberately left unprovided for

Paragraph (4) deals with the situation where the parties have foreseen a contingency and have deliberately left it unprovided for, accepting the risks and consequences of so doing. The principle of autonomy of the parties means that it must be open to the parties to do this if they wish. This situation falls to be contrasted with the situation where the parties foresee a situation but either think it will not materialise or “forget” to regulate it, without intending to accept the risks.

II.-9:102: Certain pre-contractual statements regarded as contract terms

(1) A statement made by one party before a contract is concluded is regarded as a term of the contract if the other party reasonably understood it as being made on the basis that it would form part of the contract terms if a contract were concluded. In assessing whether the other party was reasonable in understanding the statement in that way account may be taken of:

- (a) the apparent importance of the statement to the other party;*
- (b) whether the party was making the statement in the course of business; and*
- (c) the relative expertise of the parties.*

(2) If one of the parties to a contract is a business and before the contract is concluded makes a statement, either to the other party or publicly, about the specific characteristics of what is to be supplied by that business under the contract, the statement is regarded as a term of the contract unless:

- (a) the other party was aware when the contract was concluded, or could reasonably be expected to have been so aware, that the statement was incorrect or could not otherwise be relied on as such a term; or*
- (b) the other party's decision to conclude the contract was not influenced by the statement.*

(3) For the purposes of paragraph (2), a statement made by a person engaged in advertising or marketing on behalf of the business is treated as being made by the business.

(4) Where the other party is a consumer then, for the purposes of paragraph (2), a public statement made by or on behalf of a producer or other person in earlier links of the business chain between the producer and the consumer is treated as being made by the business unless the business, at the time of conclusion of the contract, did not know and could not reasonably be expected to have known of it.

(5) In the circumstances covered by paragraph (4) a business which at the time of conclusion of the contract did not know and could not reasonably be expected to have known that the statement was incorrect has a right to be indemnified by the person making the statement for any liability incurred as a result of that paragraph.

COMMENTS

A. Certain pre-contractual statements may become part of contract

Paragraph (1) reiterates the rule that certain statements made before the time of conclusion of the contract may become part of the contract even though not expressed as terms of the contract. Whether or not this is the case is dependent upon the circumstances and the reasonable expectations of the party to whom the statements are made. The paragraph enumerates some circumstances which may be particularly relevant.

Even without this paragraph the same results could often be reached by relying on the rules on unilateral promises and the interpretation of offers and other juridical acts. Also relevant would be rules on the reasonable expectations of the parties to contracts such as

sales contracts. However, the rule provides a focussed way of achieving reasonable results in a common type of situation.

A misrepresentation by a party may also give rise to a right to avoidance on the grounds of a mistake or to a right to damages for incorrect information. The fact that there are overlapping remedies does not matter. The other party may choose between remedies.

B. Special rules for professional suppliers

The rule in paragraph (2) relates only to statements by a professional supplier about the specific characteristics of what is to be supplied under the contract. Very often the statements will relate to the quality or use of goods or services but the paragraph is deliberately expressed in wide terms so as to catch whatever might be supplied under the contract. The statements may be made to the other party or publicly (e.g. in advertisements or in the course of marketing). They must be made before the contract is concluded.

Under the rule in paragraph (2) any such statement by a supplier becomes part of the contract unless one of the exceptions applies. If information given in the statement is incorrect or if an undertaking given in the statement is broken, the other party may resort to the normal remedies for non-performance of a contractual obligation.

The first exception applies if the other party to the contract was aware when the contract was concluded, or could reasonably be expected to have been so aware, that the statement was incorrect or could not otherwise be relied on as such a term. This would cover, for example, the situation where a misleading advertising statement had been publicly corrected before the contract was concluded. It would also prevent parties from creating contractual obligations out of mere advertising “puff”, or obviously outdated statements, or very vague and general statements, or statements qualified by a warning that special terms might apply.

The second exception applies if the other party’s decision to conclude the contract was not influenced by the statement. This is essential in order to introduce a causal connection between the statement and the decision to conclude the contract.

C. Liability for others

Paragraph (3) extends the liability of a professional supplier to statements made by a person advertising or marketing the services or property for the professional supplier. This goes beyond those acting as agents for the supplier and extends to independent contractors supplying services to the supplier.

D. Extended liability for others in consumer contracts

The rule in paragraph (4) applies only to contracts between professional suppliers and consumers. It extends the liability of a supplier under paragraph (2) to public statements made by a producer, professional distributor or other person in the business chain

between producer and consumer. The Article goes somewhat beyond what is currently found in the laws of most Member States but the policy is similar to that underlying Article 2(2)(d) of the Consumer Sales Directive of 25 May 1999 (Directive 99/44/EC of the European Parliament and of the Council) which provides that any public statements on the specific characteristics of the goods made about them by the seller “the producer or his representative, particularly in advertising or labelling” can be taken into account in deciding whether consumer goods are in conformity with the sale contract.

The provision in paragraph (4) is confined to consumer contracts because in the case of contracts between professionals it is expected that the purchaser of the goods or services who wishes to rely on statements made by such third parties will ask the supplier if responsibility is accepted for the statements.

Statements made by producers, distributors or other persons in the business chain are such as is supplied in advertisements, in the press or in advertising matters distributed by manufacturers or wholesale dealers.

The rule in paragraph (4) applies even though the supplier has not invoked the statement, or referred to it, when marketing the goods or services or when making the contract.

Paragraph (4) does not apply if, at the time of conclusion of the contract, the supplier did not know and could not reasonably be expected to have known of the statement.

Illustration

Before buying type Z fibreboard from S, B asks the manufacturer M whether the fibreboard, which B intends to use in the construction of a building, is fireproof. M by an error transmits the information on fibreboard T which is fireproof. S, who knows nothing of the information given to B, is not responsible for the error.

E. Right of indemnity

It could be harsh to fix a supplier with liability for incorrect statements made by others, such as manufacturers further up the business chain, if the supplier did not know and had no reason to suppose that the statements were incorrect. While it may be justifiable to give the consumer a remedy against the supplier, there is no reason why the supplier should bear any resulting loss in a question with the person who has actually made the incorrect statement. Accordingly paragraph (5) gives a right of indemnity in such circumstances.

The policy underlying this rule may be compared with the policy underlying Article 4 of the Consumer Sales Directive of 25 May 1999 (Directive 99/44/EC of the European Parliament and of the Council) which provides that:

“Where the final seller is liable to the consumer because of a lack of conformity resulting from an act or omission by the producer, a previous seller in the same chain of contracts or any other intermediary, the final seller shall be entitled to pursue remedies against the person or persons liable in the contractual chain. The person or persons liable against whom the final seller may pursue remedies, together with the relevant actions and conditions of exercise, shall be determined by national law.”

F. Merger clauses

The effect of this Article could be displaced by a merger clause stating that the terms of a contract were to be found exclusively in the contract document.

II.-9:103: Terms not individually negotiated

(1) Terms supplied by one party and not individually negotiated may be invoked against the other party only if the other party was aware of them, or if the party supplying the terms took reasonable steps to draw the other party’s attention to them, before or when the contract was concluded.

(2) If a contract is to be concluded by electronic means, the party supplying any terms which have not been individually negotiated may invoke them against the other party only if they are made available to the other party in textual form.

(3) For the purposes of this Article

(a) “not individually negotiated” has the meaning given by II.-9:403 (Meaning of “not individually negotiated”); and

(b) terms are not sufficiently brought to the other party’s attention by a mere reference to them in a contract document, even if that party signs the document.

COMMENTS

A. General purpose

The Article is not phrased as a comprehensive rule on the incorporation of non-negotiated terms into a contract. Instead, it is intended to supplement the rules governing the formation of contracts. It is applicable in addition to these general rules. Thus, consent of both parties, as defined in II.-4:101 (Requirements for the conclusion of a contract) and II.-4:103 (Sufficient agreement), is necessary to include non-negotiated terms into a contract in all cases. Consequently, the provisions on the formation of contracts in Book II, Chapter 4 apply in addition to this Article.

Based on the rules on formation of contracts, it could be sufficient for the incorporation of non-negotiated terms that the parties merely refer to these terms in their contract document or in the offer, e.g. if the offer refers to the standard terms of the offeror and the other side accepts this reference without asking to see the terms. Thus, without the provision at hand, the other party could be bound by terms without having had the

opportunity to take notice of their content. The purpose of the general rule in paragraph (1) is to require the supplier to take reasonable steps to draw the other party's attention to the terms. It is then the other party's responsibility to take actual notice of the terms. In particular if the other party is a business, it can be expected to take the trouble to become acquainted with the terms as far as necessary once the terms have been drawn to its attention.

B. Meaning of “terms not individually negotiated”

Paragraph (3)(a) refers to the definition in II.–9:403 (Meaning of “not individually negotiated”). Thus, a term supplied by one party (the supplier) is not individually negotiated if the other party has not been able to influence its content, in particular because it has been drafted in advance, whether or not as part of standard terms. The main field of application are standard terms, which are, according to the definition in Annex 1, terms which have been formulated in advance for several transactions involving different parties, and which have not been individually negotiated by the parties.

C. Before or at the time of conclusion

Non-negotiated terms must be brought to the attention of the other party when, or before, the contract is concluded. This requirement is met if the terms are attached to the offer or to the contract form used. Standard terms sent with a supplier's acceptance of the customer's offer may be treated as a modified acceptance under II.–4:208 (Modified acceptance). Terms which the seller sends with the goods the buyer has ordered may be considered as accepted by the buyer when the buyer accepts the goods. However, terms sent with a supplier's bill which the customer receives after having received the performance will not bind the customer.

D. Reasonable steps

If the other party is unaware of the terms, the supplier has to take reasonable steps to draw the other party's attention to them. This requirement is met if the supplier has communicated the terms to the other party and has taken steps which, under normal circumstances, are sufficient to let the other party know that there are non-negotiated terms and where to find them. Usually, it will be sufficient:

- if the terms are part of the document signed by the parties,
- if the terms are reprinted on the reverse side of an offer with the offer referring to them,
- if they are attached to an offer or a contract document with the offer or contract referring to them, or
- if they are communicated to the other party and if the contract or the declarations forming the contract refer to them so that it is sufficiently clear that the terms should be incorporated.

Paragraph (3)(b) is a clarification of paragraph (1). It makes clear that a mere reference to terms in the contract document by the supplier, even if the document is signed by the other party, is not sufficient to draw the other party's attention to these terms. Whilst a

mere reference to certain terms may be sufficient to draw the attention to the fact that those terms exist, such a reference cannot draw any attention to the terms themselves. This may be different if the other party knew of the terms beforehand – for instance, because in earlier similar contracts between the parties the supplier brought the terms to the other party’s attention; then a reference to them may suffice. If the other party does not know of the terms referred to, they must be included in the document or other steps must be taken to inform this party of them.

Illustration 1

The parties sign a contract drafted by A. In bold letters above the signature line, the contract refers to A’s standard terms. B signs the contract without having received the terms previously. Despite its bold print, the reference in the contract is a mere reference. The terms are not included.

Paragraph (1) applies only if the other party is unaware of the terms. It does not apply if the other side knows the terms and the supplier refers to them. This may be the case if the other party knows the terms from previous contracts or if the terms are generally known in a certain industry or by the customers of a certain industry (and the other party is such a customer).

Illustration 2

In the construction industry of a Member State, most contracts refer to certain standard terms (known as the “Construction Standard Terms”). A construction company C wishes to use these terms in a subcontract with another domestic construction company S. It is sufficient to refer to the “Construction Standard Terms” in the contract between C and S. C does not have to communicate these terms to S.

Illustration 3

The facts are as in Illustration 2; but C wishes to use the Construction Standard Terms in a contract with a foreign company F which has no experience in this Member State’s market. C has to take reasonable steps pursuant to paragraph (1).

E. Waiver

A party cannot unilaterally meet the requirement of bringing standard terms to the attention of the contracting partner by a term in its offer or at a notice board in its premises. However, before or after the conclusion of the contract, the other party may waive the right to be informed of the terms, and such a waiver can be implied when under the circumstances it would not be reasonable to require such information.

Illustration 4

On Friday A sends an advertisement to B, a newspaper, asking B to publish it on Sunday. B receives A’s letter on Saturday. It cannot be required to inform A about its general conditions regarding advertising before it publishes the advertisement in the paper.

According to the rationale of the present Article, a waiver included in non-negotiated terms of the party supplying the terms is not sufficient.

F. Usage

It may follow from a usage that terms which have not been individually negotiated may be binding upon a party who did not know of them. Thus, in a particular trade, terms which have been published by the association of suppliers as the terms which its members will apply, may be binding upon customers without further steps by suppliers who are members of the association. Such usages may even bind foreign customers, cf. II.– 1:104 (Usages and practices).

G. Effects

Terms which have been duly brought to the attention of a party will become part of the contract. If a party has not taken appropriate steps to bring the terms to the other party's attention the contract is treated as having been made without the terms, if the other party wishes this result. It should be noted that the rules on non-negotiated terms clearly distinguish between the incorporation of such terms into the contract (which is dealt with in the present Article) and their fairness. Terms may be incorporated into a contract and may nevertheless be not binding on the party who did not supply them according to II.– 9:409 (Effects of unfair terms). If, on the other hand, the terms are not part of the contract under the present Article, the question of fairness does not arise.

H. Textual form required for a contract to be concluded by electronic means

Paragraph (2) supplements II.–3:105 (Formation by electronic means), paragraphs (1)(e) and (2), which reflect Art. 10 paragraph (3) of the E-Commerce Directive 2000/31/EC. However, the Directive does not make clear which sanction for the violation of the duty to provide contract terms in electronic form applies (besides the possibility to file injunction proceedings against the supplier). Paragraph (2) of the present Article imposes on the supplier, who did not make the terms available in electronic form, the same sanction provided in paragraph (1), i.e. the terms do not become part of the contract if the other party wants this result. Following the model of the E-Commerce Directive 2000/31/EC, paragraph (2) of the present Article is not limited to consumer contracts but applies to all contracts.

Electronic means include electrical, digital, magnetic, wireless, optical, electromagnetic, or similar means, cf. I.–1:106 (Meaning of “signature” and similar expressions), paragraph (4). The terms are made available if the recipient is able to read them before the conclusion of the contract with the use of standard technical equipment. Textual form is defined under I.–1:105 (Meaning of “in writing” and similar expressions), paragraph (2) and means a text which is expressed in alphabetical or other intelligible characters by means of any support that permits reading, recording of the information contained therein and its reproduction in tangible form. This includes the presentation of the terms on an

internet site in a such a way that they can be downloaded, stored and printed by the other party.

J. Particular requirements for consumer contracts

The present Article does not contain stricter requirements for the incorporation of terms into consumer contracts. However, according to II.–9:408 (Factors to be taken into account in assessing unfairness), paragraph (2), it can lead to the unfairness of a term, if the consumer was not given a real opportunity to become acquainted with the term before the conclusion of the contract.

II.–9:104: Determination of price

Where the amount of the price payable under a contract cannot be determined from the terms agreed by the parties, from any other applicable rule of law or from usages or practices, the price payable is the price normally charged in comparable circumstances at the time of the conclusion of the contract or, if no such price is available, a reasonable price.

COMMENTS

A. Introduction

This Article and the Articles which follow it are intended to govern cases in which there is no doubt that the parties intended to be bound by the contract, but some element of it is not determined sufficiently precisely for it to be given effect on the basis only of what is expressed in it. The Articles create rules which can be used to “save” the contract in those cases in which it seems reasonable to do so because it is probable that the parties meant there to be a binding contract. This is in accordance with the approach taken in many Member States’ laws. Others require that the price be determined or determinable from the terms of the contract.

The commonest case of a need for supplementation of the express terms is where the price is not fixed, and it is this which is covered by the present Article.

B. Requirements for rule to apply

Firstly, there must be a contract. The Article never applies if the parties have never reached agreement and therefore have not concluded a contract at all; if, for instance, during the negotiations the parties have been unable to come to any agreement over the price. Similarly, if the parties left the question open for future negotiation and when this took place they were unable to reach an accord, the court may not intervene to fix a reasonable price. However, the subsequent behaviour of the parties may show that they did intend to enter contractual relations. In this case, the rule in the Article can be applied to fill the gap.

Illustration 1

Construction Company A normally hires the cranes it uses for its works from Company B. The latter informs A that it is increasing its prices “to a figure to be agreed by the parties”. Before any agreement on the price has been reached A orders a further crane. The crane is delivered and put into use. The contract may be considered as concluded at a normal or reasonable price.

Secondly, the contract must be of a type where a price is payable – not, for example, a contract to give something or a contract of barter.

Thirdly, the Article applies only where the price cannot be determined from the terms agreed by the parties (expressly or tacitly) or from any other rule of law (that is, other than the current rule) or from usages or practices. Usually the price will be fixed by the express terms of the contract. Quite often it will be fixed by tacit agreement. For example, there may be a price list on display. Even if nothing is expressly said about price it may be clear that the tacit agreement was that the listed price should be payable. In such cases of clear tacit agreement the present Article does not need to apply and will not apply. In a free market economy it is rare for the price to be fixed by law but this could happen. For example, there may in certain countries be a fixed price payable for prescription medicines bought by certain categories of people from pharmacists, the State making up any difference. Usages and practices established between the parties may also enable the price to be precisely determined. Where this is the case there is no need for the present Article to apply and it would be inappropriate for it to apply. For example, if it is customary for a contract with an architect to be at the scale fee established by the architects’ professional association, the price is already determinable.

C. Practical applications

Notwithstanding these essential restrictions, there are many cases where the Article could apply. The Article may, for example, find application in situations of emergency.

Illustration 2

A helicopter carrying urgently needed medical supplies has to land after having engine trouble. The carrier telephones the helicopter manufacturer and asks for a repair engineer to be sent as soon as possible. Nothing is said about the price. The contract is valid nonetheless and is considered to be one for a reasonable price.

In some other contracts it is not the custom to ask the price in advance; or the debtor leaves it to the creditor to fix the price (e.g. when an opinion is sought from a professional person).

In yet other cases the parties may think they have agreed on the price and may perform the contract and may then discover that there was in fact no agreement.

D. The rule

Where the Article does apply, the price payable is the price normally charged in comparable circumstances. If there is no such price then a reasonable price is payable.

On what constitutes a reasonable price, see the definition of “reasonableness” in Annex I.

II.-9:105: Unilateral determination by a party

Where the price or any other contractual term is to be determined by one party and that party’s determination is grossly unreasonable then, notwithstanding any provision in the contract to the contrary, a reasonable price or other term is substituted.

COMMENTS

The text first of all recognises that the parties may leave the price to be determined unilaterally by one of them. As in the majority of Member States’ laws, this does not prevent the formation of a contract. However, possibly unlike under some laws, the determination must be made in a reasonable manner. If it is not, the court may intervene to protect the debtor against the creditor fixing the price abusively. Thus if a broker were to fix its commission at a grossly unreasonable level, the court could reduce it to a reasonable level.

The rule may work the other way round if it is the debtor who is to fix the price. The court could then increase an unreasonably low price.

The operation of this Article cannot be excluded by contrary agreement; any clause (which might be a standard clause) which purported to exclude the jurisdiction of the court to review a price fixed unilaterally will be of no effect.

It should be noted that, to prevent abuse of this section, the section stipulates that the price or other term fixed must be grossly unreasonable.

As to what is reasonable, see the definition in Annex 1.

II.-9:106: Determination by a third person

(1) Where a third person is to determine the price or any other contractual term and cannot or will not do so, a court may, unless this is inconsistent with the terms of the contract, appoint another person to determine it.

(2) If a price or other term determined by a third person is grossly unreasonable, a reasonable price or term is substituted.

COMMENTS

A. Term to be fixed by court

Using a variety of forms and types of clause, it is common practice in international contracts for the price or part of it to be fixed by a third person chosen by the parties.

It may be that the price for a work of art is to be fixed by an “expert opinion”. The whole or a fraction of the price may be left to be determined either as at the date of the contract or later. For example in the FIDIC Conditions for Engineering Work it is provided that the engineer will fix the price for, among other things, additional work. If the engineer does not do so, or does not do it properly, the contract is not void: the contractor is entitled to a reasonable sum.

Frequently the third person is in a contractual relationship with one of the parties, but still acts as a third person if expected to act independently (for example, the consulting engineer under the FIDIC conditions).

The purpose of the Article is to save the contract in the case where the third person chosen cannot carry out the task or refuses to do it. Of course, the parties may agree on a replacement, but it can happen that one refuses to do so in order to escape a contract which has turned out to be disadvantageous.

One solution would be to hold that the contract fails to take effect. The preferred general policy is, however, to save contracts whenever this is likely to be in accordance with the wishes of the parties. It seems better to give the court power to replace the third person. Of course, if both parties wish to terminate their contractual relationship they can do so.

The rule does not apply where this would be inconsistent with the terms of the contract. The parties may expressly or implicitly agree that the third person is to be irreplaceable, for instance when an expert is chosen for unique personal qualities. In this case, if the third person does not act, the contract falls.

B. Term fixed by third person unreasonable

If the price or other term fixed by the third person is grossly unreasonable, it seems coherent, particularly in the light of the preceding Article which allows for the revision of a price fixed unilaterally by one party, to substitute a reasonable price or term. However, taking into account that the parties in choosing valuation by a third person have taken the risk of errors, a reasonable price or term will be substituted under this Article only when the error is manifestly unreasonable, such as a clear mistake of arithmetic or a grossly wrong valuation. If the parties cannot agree on what is a reasonable price or term, this will have to be fixed by a court.

II.-9:107: Reference to a non-existent factor

Where the price or any other contractual term is to be determined by reference to a factor which does not exist or has ceased to exist or to be accessible, the nearest equivalent factor is substituted unless this would be unreasonable in the circumstances in which case a reasonable price or other term is substituted.

COMMENTS

In periods of inflation it becomes common practice to use price fluctuation clauses. There are other circumstances where the price is to be determined by reference to an external factor. But it can happen that the index of prices, or other external factor, selected as the basis of the clause ceases to be available, perhaps because the organisation which published it stops doing so or because the components of the index are changed so that it no longer complies with the clause. It is not easy to determine the consequences of the disappearance of the index and thus of the indexation. Does the contract continue at a price fixed in accordance with the last price published in the index? Or does it cease to be enforceable? It seems preferable in this situation, unless it would be unreasonable in the circumstances, to use the nearest equivalent index, which if necessary can be determined by the court, so that the contract can continue more or less as intended by the parties.

Illustration 1

In a long-term lease the rent is indexed by reference to the index of construction costs published by the Academy of Architects. The latter discontinues publications of the index. The index of construction costs published by the National Statistical Institute may be substituted.

The rule can apply to factors necessary to determine other terms than price.

Illustration 2

An employment contract provides for holidays in accordance with the nationally agreed terms of employment of a certain category of employees. When this category of employees ceases to exist, there is no longer such an agreement. The nationally agreed terms on holidays for the nearest equivalent category of employees may be substituted.

Where it would be unreasonable to apply the nearest equivalent factor, a reasonable price or other term is substituted.

II.-9:108: Quality

Where the quality of anything to be supplied or provided under the contract cannot be determined from the terms agreed by the parties, from any other applicable rule of law or

from usages or practices, the quality required is the quality which the recipient could reasonably expect in the circumstances.

COMMENTS

It may be helpful to provide a rule to supplement the parties' agreement on the quality of what is to be supplied or provided under the contract. If the quality cannot be determined from the terms agreed by the parties, from any other applicable rule of law or from usages or practices, the quality must be what the recipient could reasonably expect.

The scope of this Article will depend on how many particular contracts are eventually regulated by Books of their own which provide default rules on quality. The Article may eventually have only a limited residual application.

One effect of the Article is that in a contract which does not make provision for quality, which cannot be supplemented by usages or practices on this point and which is of a type where there are no special default rules on quality, the supplier need not supply an abnormally high quality which could not reasonably be expected.

In some cases it may be easy to determine the quality which could reasonably be expected. For example, there may be evidence that contracts of that type normally provide for the quality to comply with a standard set by some regulatory body or respected institution. In other cases it may be necessary to refer to a range of factors. In particular, the nature of what is supplied or provided and the price paid will be of great importance. The circumstances in which the contract was concluded may also be of importance. For example, it may be clear that a particular service was required as a matter of urgency and that both parties placed the emphasis on speed rather than quality. On the other hand, the reverse may be true: both parties may have understood and accepted that some delay was acceptable in order to achieve a better than usual quality.

Section 2: Simulation

II.-9:201: Effect of simulation

(1) When the parties have concluded a contract or an apparent contract and have deliberately done so in such a way that it has an apparent effect different from the effect which the parties intend it to have, the parties' true intention prevails.

(2) However, the apparent effect prevails in relation to a person, not being a party to the contract or apparent contract or a person who by law has no better rights than such a party, who has reasonably and in good faith relied on the apparent effect.

COMMENTS

A. Definition and types of simulation

Simulation is the situation in which the parties, with the aim of concealing their real intentions, have made two agreements: an overt one (the sham transaction) and another which is intended to remain secret. This covert agreement is sometimes embodied in a document (variously called a back-letter, counter-letter or side-letter). The situation is therefore different to the case where there is a single agreement which is merely ambiguous or vague, so that its meaning falls to be discovered by interpretation. However, there is an overlap with the provisions on interpretation and it may be a matter of choice which rule to apply. For example, if the parties for reasons of commercial secrecy use the word “refrigerators” in their written contract so that clerks and secretaries seeing contractual documents will not know that it relates to some commercially sensitive new equipment, this could be regarded either as a case of simulation or as a case where the common intention of the parties is to use a word in a special sense. Because of this overlap it is important that the rules on simulation should be to the same broad effect as the rules on interpretation.

The simulation may have the aim of making it appear that there is a contract which in fact the parties have no intention of concluding. For example, a debtor who is threatened with distraint of goods by creditors may pretend to sell the goods to a friend, neither having any intention that ownership will be transferred. This type of situation is covered by the reference in the Article to “an apparent contract”. The simulation may also relate to the nature of the transaction. For example, there may be a gift disguised as a sale with a secret agreement that the price will not be paid. Or it may be simply the content of the agreement (e.g. the price) which is disguised by the simulated contract. Finally, the simulation may relate to the true beneficiary of the contract. For example, a sale is apparently concluded with one person when the true buyer is another person. In this last type of case there may be, but will not necessarily be, an overlap with the rules on representation. In any case of conflict, the rules on representation will prevail because they are the special rules for the situation.

Although simulation is dealt with in different ways in different legal traditions, paragraph (1) represents what is found in most legal systems. There is even more divergence over the question of the effect as against third parties. Paragraph (2) adopts what is considered to be a fair and appropriate rule. See Comment C.

B. Effect as between the parties

As between the parties, it is the true agreement which prevails if the contract is otherwise valid. Thus simulation is not in itself a cause of invalidity when it does not have a fraudulent or illegal purpose. It is the covert act which expresses the real intentions of the parties and it follows from the principle of freedom of contract that it should govern.

Illustration 1

A, a wine merchant, is in urgent need of cash. As it does not want to drive down market prices and as it cannot find a buyer quickly at the current price in a dull market, it sells part of its stock to B, apparently at the current market price but with a counter-letter to the effect that the real price will be 30% lower than the market price. A cannot recover the full market price from B, only the price fixed in the counter-letter.

For the same reason one party cannot, as against the other, use the apparent agreement as a defence.

C. Effect as against third parties

It would, however, be contrary to the requirements of good faith and fair dealing to allow the parties or one of them to invoke the secret true agreement in a question with a third party who has reasonably and in good faith relied on the simulated contract. Paragraph (2) provides protection for the third party in this type of case. The rule that an assignee has no better right than the assignor is, however, preserved: an assignee who was met by a defence based on simulation would have remedies against the assignor, not the other party to the simulated contract. Any other rule would have the effect that a party to a simulated contract could cheat the other party by the simple expedient of assigning the apparent rights under the contract for their apparent full value.

Illustration 2

A contract between A and B apparently confers a right on C and is in such terms that C can enforce the right against A. C is informed of the right and, reasonably and in good faith, incurs expenditure in reliance on it. A and B then turn round and say that their true agreement was that the right conferred on C was only conditional and that the conditions have not been met. This argument based on simulation will not succeed. C is entitled to rely on the apparent effect.

Illustration 3

The facts are as in Illustration 1. Immediately after the conclusion of the contract with the simulated price, A assigns the right to payment under the contract to C for a fraction less than the full price apparently payable under the contract. C then attempts to recover the full price from B. B can reply that in a question with A he is only liable to pay the discounted price and that C, as A's assignee, has no better right. C will have a remedy against A.

The rule in paragraph (2) may however be displaced by special rules for special situations. In particular there may be situations involving deliberate simulations where it would be reasonable to provide that an innocent third party should have the option of invoking either the apparent effect or the true effect.

D. Risks of simulation

It is not the purpose of this Article to deal with the possible risks of simulation for the parties. In fact, however, such risks are often real, particularly if the parties are disguising a transaction for some illegal or fraudulent or tax-avoiding purpose. The contract may well be avoided under Chapter 7 (Grounds of Invalidity).

Section 3: Effect of stipulation in favour of a third party

II.–9:301: Basic rules

(1) The parties to a contract may, by the contract, confer a right or other benefit on a third party. The third party need not be in existence or identified at the time the contract is concluded.

(2) The nature and content of the third party's right or benefit are determined by the contract and are subject to any conditions or other limitations under the contract.

(3) The benefit conferred may take the form of an exclusion or limitation of the third party's liability to one of the contracting parties.

COMMENTS

A. Background, scope and purpose

All but a very few of the laws of the member States now recognise that a contract may create rights in a third party beneficiary. Even English law (for long hostile to the idea of third party rights under contracts) did so in the Contracts (Rights of Third Parties) Act 1999.

The Principles of European Contract Law already contained an Article on this subject (Article 6:110). That provision was a considerable achievement at the time. Since then, however, there have been significant developments, including the English Act. On this subject the UNIDROIT Principles have also now an Article which in many ways is an advance on the PECL provision. In these circumstances it has been considered appropriate to reconsider and revise the treatment of stipulations in favour of a third party.

The Article deals with the situation which arises when a contract confers a right or benefit on a third party. This is not uncommon. For example, a contract between a man and an insurance company may provide for a benefit to be paid to the man's widow. Or a contract between a person and a carrier may provide for the goods to be delivered to a named third party. Or a transport insurance contract may provide for the insurance company to pay the amount insured to any person who becomes owner of the insured goods within the period covered by the contract and who suffers loss of a type covered by

the policy. Or a contract with a florist may provide for flowers to be sent to a person named by the buyer. Or a grandparent may put money in a bank account for a grandchild, the contract with the bank providing for payments to be made to the grandchild. Or the parties to a contract may agree that one of them renounces a right or claim against the third party or agrees to a limitation of the third party's liability.

The purpose of the stipulation in favour of the third party is often to avoid an additional transaction. If such stipulations were not legally possible, the contracting party who wishes to confer a benefit on the third party would have first to receive performance from the other and then perform to the third party; or would have to assign the right to performance to the third party.

It is because the nature of the benefit depends entirely on the agreement of the contracting parties, and because the situations covered are so various, that the Article refers in paragraph (1) to a "right or other benefit". The word "right" alone might not be read as covering for example the benefit of an immediate renunciation of a right against the third party, or the benefit of a limitation of liability clause in favour of the third party, or the benefit of an immediate grant of permission or authority to a third party. It might also be open to argument that a "right" which is available or removable at the sole discretion of someone else is not really a right so much as a mere expectation or interest. The use of the word "benefit" avoids these problems.

B. Agency and trusts not covered

The Article does not cover the case where the person who receives a contractual undertaking acts as a representative or legal representative of the "third person" since in that case the "third person" is in fact the other party to the contract. Nor does the Article cover the case where a trustee or fiduciary concludes, as such, a contract which is for the benefit of a beneficiary under the trust or fiduciary relationship. In such a case the agreement between the contracting parties is to confer a right or benefit on the trustee or fiduciary as such. The relationship with the beneficiary would be indirect and would be governed by the law governing the trust or fiduciary relationship.

C. "Legal beneficiaries" not covered

Nor does the Article deal with situations where the promisor did not intend to give third parties any rights under the contract but where the law extends the promisor's obligation vis-a-vis the promisee to cover other persons as well. Under the laws of some countries the seller's warranty to the buyer extends to members of the buyer's household. If a breach of the warranty causes personal injury to them, they have a direct claim in contract against the seller.

D. The third party need not be identified at the time of conclusion of the contract

The beneficiary need not be known when the contract is concluded. An insurance company may promise the policy-holder to pay the insurance proceeds to any future owner of the goods insured. A bank may promise a customer to pay the purchase price to

any seller who delivers a certain piece of equipment to the customer. A contract for the payment of a pension may provide for the beneficiary to be nominated by one of the parties at a later date. An employer who rents accommodation for workers may not know the identity of particular tenants at the time of the contract but may reserve the right to nominate tenants later. There are many similar examples. It goes without saying; however, that before a third party could enforce or assert a right under the contract the third party would have to be identified or identifiable under the contract. It also goes without saying that the third party need not be a single individual or legal person but could be several persons or a class of persons identified as such.

E. The contract determines the nature and content of the third party's right or benefit

In many cases third parties have merely incidental or factual benefits under contracts and acquire no legal rights which they can enforce or assert. For example, a contract between a local authority and a developer for the development of a public park may provide benefit to many other people but they would not acquire rights which they could enforce or assert under the contract. Paragraph (2) of the Article makes it clear that the nature and content of the third party's right or benefit are determined by the contract. In particular, it is the intention of the contracting parties as expressed or implied in the contract which determines whether the third party acquires a right which can be enforced by the third party against a contracting party. In some cases, the contract may make it clear that it is only the other contracting party, and not the third party, who has direct rights against the other contracting party. In other cases, this result may follow from the nature of the contract and the absence of any clear intention to give the third party direct rights. For example, a contract between X and Y whereby X agrees to pay off Y's debts would not of itself give the creditors a direct right against X. In yet other cases, the nature of the contract may reveal an implied agreement that the third party is to have direct rights against a contracting party. Everything depends on the express or implied agreement of the contracting parties.

Illustration 1

P opens a bank account in her own name and pays €800 per month to the account. Under the contract between P and the bank, the bank promises to pay sums, up to the amount in the account, to P's son B on B's demand. B may claim performance.

Illustration 2

A landlord L gives P permission to erect high voltage lines over a quarry which is worked by T, a tenant. P has promised L to pay an indemnity for damage done to T's property. It can reasonably be concluded that there is an implied agreement that T has a direct claim against P when damage is done.

Illustration 3

When taking a lease P, which intends to carry on production of inflammables, promises the landlord L that it will compensate the other tenants for any increase of their household insurance premiums which is caused by P's dangerous activity.

The tenants who are informed by L about P's promise have a direct claim against P to have the increase of their premiums reimbursed.

The governing principle is the autonomy of the contracting parties: it is up to them to shape the nature and content of the third party's benefit. They may provide, for example, that the benefit is to be subject to conditions which have to be fulfilled by either the other contracting party or the third party. For example, a contract between a man and a sporting coach for lessons to be given to the man's daughter may provide that each lesson will be provided only if the fee for it is paid by the daughter at the beginning of the lesson. The parties may provide for the right or benefit to be subject to revocation or modification by one of them or both of them. For example, a contract between an individual and a pension provider may enable the individual to change the beneficiary by nomination.

Third parties' rights often accrue in contracts for the carriage of goods. A carrier promises the consignor to deliver the goods to a consignee. The conditions under which the consignee may claim delivery of the goods are provided for in international conventions. They vary depending upon the special procedures followed for each means of transport. As a rule, however, the consignee acquires a right to have the goods delivered when they have arrived at the place of destination, see Article 13 of the Warsaw Convention on the International Carriage by Air, Article 16(4) of the Uniform Rules Concerning the Contract for the International Carriage of Goods by Rail (CIM) and Article 13 of the Convention on International Carriage of Goods by Road (CMR).

However, under most of the transport conventions the consignor has a right to dispose of the goods in transit. The carrier acting as representative of the consignor must follow the consignor's instructions, see Article 20 of CIM and Article 12 of CMR. This right to dispose of the goods ceases when the consignee claims the goods after they have arrived at the place of destination. It also ceases to exist when the carrier has handed over the transport document to the consignee, see e.g. Article 21(4) of CIM and Article 12(2) of CMR. These rules are consistent with the provisions of Article 6.203.

Another provision frequently found in contracts for the carriage of goods is a provision excluding or limiting the liability of third parties, such as the master and crew of the ship, or stevedores engaged in loading or unloading the goods. The benefit of such an exclusion or limitation of liability clause would be within the scope of the present Article. Paragraph (3) of the Article makes this clear for the avoidance of any doubt about this matter of practical importance. It is also expressly covered in the UNIDROIT Principles. (Article 5.2.3).

II.-9:302: Rights, remedies and defences

Where one of the contracting parties is bound to render a performance to the third party under the contract, then, in the absence of provision to the contrary in the contract:

(a) the third party has the same rights to performance and remedies for non-performance as if the contracting party was bound to render the performance under a binding unilateral promise in favour of the third party; and

(b) the contracting party may assert against the third party all defences which the contracting party could assert against the other party to the contract.

COMMENTS

Once it has been decided that, under the contract, one of the parties owes an obligation to the third party and the third party has a corresponding right to performance, the question arises as to the remedies available to the third party for the enforcement of performance or in the case of non-performance. These are not necessarily the same remedies as the other contracting party would have if the obligation were owed to that contracting party. The significant difference between the two situations is that there will generally be some mutuality of rights and obligations between the contracting parties. As between one contracting party and the third party, however, there is not the same mutuality: the third party has a right but no obligations. Remedies which depend on mutuality – withholding of counter-performance, termination of the contractual relationship so as to put an end to the obligation to render counter-performance, reduction of price – have no application. The third party is much more in the position of the beneficiary under a unilateral juridical act.

This is why the Article provides that the third party is to have the same rights to performance and remedies for non-performance as if the contracting party was bound to render the performance under a binding unilateral promise. This means that the third party will be able to obtain a court order for performance, subject to the usual qualifications, or obtain an award of damages for non-excused non-performance. The third party will not, however, be able to withhold performance or terminate the contractual relationship between the two contracting parties, even if there is fundamental non-performance. That may seem self-evident. Nor will the third party be able to terminate, for fundamental non-performance, the legal relationship between the contracting party who owes the obligation and the third party. The main point of termination for fundamental non-performance is to relieve the aggrieved party of future obligations of reciprocal performance. This does not arise in the present situation. These rules are subject to any provision in the contract to the contrary. For example, the contract may provide that only the other contracting party is to be able to enforce the obligation owed to the third party.

Paragraph (b) regulates the question of the defences available to the contracting party who owes the obligation. The normal rule is that the contracting party may assert against the third party all defences which could be asserted against the other contracting party.

Illustration 1

P has taken out a single premium insurance policy on his own life for the benefit of B. P has, however, failed to disclose a significant medical condition which

would, as between P and the insurance company, C, give C a defence to any claim under the policy. C can assert this defence against B.

Again, however, the rule in (b) is only a default rule. The contract may provide for another solution, expressly or by implication.

Illustration 2

A buyer and a bank contract for the bank to provide an independent personal security on first demand for the benefit of the seller. The whole point of the contract is to provide the seller with an absolute assurance of payment. The buyer has misled the bank as to the buyer's financial position. It is clear that the bank could not invoke this misrepresentation against the seller in order to refuse to meet its obligation to the seller. That would defeat the whole point of the contract. (See also IV.G.-1:101 (Definitions) in relation to the nature of an independent personal security and IV.G.-3:104 (Independent personal security on first demand).)

The focus of the Article is on the position of the third party. The position of the contracting parties depends on the general contract rules and on the terms of the contract. In the absence of any provision to the contrary each contracting party will continue to have the normal rights and obligations of a contracting party towards the other contracting party. It will very often be the case that there will be rights and obligations between the contracting parties which are independent of the right or benefit conferred on the third party. For example, a man who concludes a contract with a pension provider for a pension for his widow may have rights under the contract to annual information about the value of the pension. A person who concludes a contract with a carrier may have rights against the carrier to have the goods picked up at a certain time and place and those rights may have nothing to do with the carrier's obligation to deliver the goods to a third party.

In some cases there is a theoretical risk of double liability. A contracting party might be liable to the other contracting party for not performing in favour of the third party and also liable to the third party. This is only a theoretical possibility, however, because the parties would be most unlikely to provide expressly for this and it would not be reasonable or in accordance with the requirements of good faith and fair dealing to imply an agreement to this effect.

II.-9:303: Rejection or revocation of benefit

(1) The third party may reject the right or benefit by notice to either of the contracting parties, if that is done without undue delay after being notified of the right or benefit and before it has been expressly or impliedly accepted. On such rejection, the right or benefit is treated as never having accrued to the third party.

(2) The contracting parties may remove or modify the contractual term conferring the right or benefit if this is done before either of them has given the third party notice that the right or benefit has been conferred. The contract determines whether and by whom and in what circumstances the right or benefit can be revoked or modified after that time.

(3) Even if the right or benefit conferred is by virtue of the contract revocable or subject to modification, the right to revoke or modify is lost if the parties have, or the party having the right to revoke or modify has, led the third party to believe that it is not revocable or subject to modification and if the third party has reasonably acted in reliance on it.

COMMENTS

A. The third party may refuse the right or benefit

Paragraph (1) of this Article makes it clear that the beneficiary may refuse to accept the right or benefit. This is necessary because nobody has to accept an unwanted benefit. If the benefit is rejected, it is considered never to have accrued to the beneficiary. To be effective, rejection must, however, take place before the right or benefit has been expressly or impliedly accepted. It is not necessary, and would not be reasonable, to allow the third party to enjoy a right or benefit for many years and then to reject it with retrospective effect. Under paragraph (1) rejection is effected by notice to either of the contracting parties. Normally the third party would give notice of rejection to the contracting party who sent notice of the benefit. This could be either of them. In Illustration 1 to the preceding Article, for example, either the father might tell the son that he had opened the account for him or the bank might tell the son that the account had been opened and give him information about how to operate it. The obligation to cooperate would require the contracting party who receives notice of the rejection to convey this information to the other party. In some cases, rejection may amount to a breach of a separate contract between one of the contracting parties and the third party but this does not have to be regulated by the Article.

Illustration 1

A seller of goods contracts with a carrier to deliver them to the buyer. The buyer refuses to accept delivery. This may or may not be a non-excused non-performance of the buyer's obligation under the sales contract to take delivery of the goods but that is a question between buyer and seller, not between buyer and carrier.

Of course, the third party can, in accordance with general principles, renounce the right non-retrospectively at any time.

B. Revocation or modification by the contracting parties

The law on this question has to reconcile two doctrines. First, the terms of a contract can always be modified by the contracting parties and they can terminate their contractual

relationship by agreement at any time. Second, a right is something on which the holder of the right can rely: once conferred it should take effect according to its content. That content may of itself provide for it to be revocable or modifiable. But if the right is conferred without any such qualifications it should not be within the control of anybody other than the holder of the right.

Paragraph (2) reconciles these two ideas in the following way. First, the contracting parties remain free to modify the terms of their contract so long as neither of them has notified the third party of the right or benefit conferred. Under the rules on notice in Book I the notice would become effective when it reached the third party. Up until that time the terms of the contract are a matter entirely for the parties to it. There is no reason to modify the general rule that the parties control the terms of their contract. At that stage the third party has no reason to suppose that a benefit is to be conferred and has no rights or expectation interests which demand protection. This approach is consistent with the approach taken under these Articles to unilateral juridical acts. A unilateral promise to pay X €100, even if written down and intended to be binding, has no effect until communicated to X. The promisor can have a change of mind after writing out the promise and can tear up the document. In the present situation the two contracting parties acting together have the same freedom of action. It will be noted that paragraph (2) says that the parties can remove or modify the contractual term. It does not say that they can revoke or modify the right or benefit because at this stage no right or benefit has yet been conferred.

Illustration 2

As part of a separation agreement a husband and wife agree that the husband will pay the wife's mortgage payments for a period of two years. The intention is for the husband to undertake a direct obligation towards the lender and for the lender to have a direct right against the husband. Before the agreement has been notified to the lender, the husband receives legal advice to the effect that it would be better from the tax point of view for him to make increased alimentary payments to the wife and for her to pay the mortgage herself. The husband and wife can tear up their agreement or modify it to provide for payments to be made to the wife herself. The third party has acquired no rights.

Illustration 3

The purchaser B has promised the seller V that B will pay the price to F which has financed V's acquisition of the goods. Later, but before any notification to F, B and V agree that B should pay the price to V. F, even if by chance becoming aware of what B and V had originally agreed, cannot claim the purchase price.

It should be noted that the rule in the first sentence of paragraph (2) does *not* say that once the conferral of the right or benefit has been notified to the third party it becomes irrevocable. Whether or not it is revocable at that stage depends, as we have seen, on the content of the right or benefit as determined by the contract. This is made clear, for the avoidance of any doubt, by the second sentence of paragraph (2). The right or benefit

conferred may well be one which can be revoked or modified by one or both of the contracting parties.

Illustration 4

P has made B a beneficiary of a life insurance policy P has taken out with C, on terms that P may change the intended beneficiaries. B has been notified of this and informed of the terms of the policy. P may alter the beneficiary from B to D, but after P's death P's executors cannot do so.

If, however, the contract is to the effect that an irrevocable right is conferred on the third party and that the content of the right, once conferred, cannot be modified by either or both of the contracting parties then a new legal relationship is created which is quite distinct from the contractual relationship between the contracting parties. It is a relationship between the contracting party who undertakes an obligation to the third party and the third party who holds the corresponding right. That relationship is, in these circumstances, beyond the control of the contracting parties. The contracting parties could terminate their own contractual relationship by agreement at any time but this would not affect the relationship between one of them and the third party. In some cases both contracting parties may undertake obligations To the third party, but that does not affect the applicable principles.

It would be possible for the law to provide that the contracting parties could modify or revoke the right or benefit, even after it had been effectively conferred and even if it was in terms irrevocable, at any time before the third party had accepted it or reasonably acted in reliance on it. This is the solution adopted in the UNIDROIT Principles Article 5.2.5. It is not, however, the solution adopted by the present Article. It would not be coherent With the solution adopted for rights conferred by unilateral juridical acts or indeed with the general notion of a right, which is that the holder of the right is not subject to the mere whims of others. The approach adopted here is that if the parties want to be able, or if one of them wants to be able, to revoke or modify the right or benefit after it has been notified to the third party, this should be provided for in their contract.

Illustration 5

P has made B the beneficiary of a life insurance which P has taken out with C. B has been notified of this and sent a copy of the policy document. The policy provides that P may stop paying premiums at any time and that the surrender value of the policy will then be payable to P. The content of B's right has been determined by the contract. B's right will be dependent on P's continuing to pay the premiums.

Illustration 6

The facts are the same as in the preceding Illustration except that the policy is a single premium policy and does not allow P to modify its terms or otherwise affect B's right. P has paid the single premium and B has been notified of the benefit conferred and sent a copy of the policy. In this case P and C could not

revoke or modify B's right. It is irrelevant whether B has accepted the right or acted in reliance on it.

C. Reliance on revocable right or benefit

In some cases it may not be clear to the third party that the right or benefit conferred is, under the contract, intended to be revocable by one or other of the contracting parties. In such cases the requirement of good faith and fair dealing would prevent revocation if the third party had reasonably acted in reliance on the right. Paragraph (3) makes this clear for the avoidance of any doubt. If, on the other hand, it had been made clear to the third party that the right was revocable then the third party would take the risk of acting in reliance on it.

Section 4: Unfair terms

II.-9:401: Mandatory nature of following provisions

The parties may not exclude the application of the provisions in this Section or derogate from or vary their effects.

According to this Article the provisions of the DCFR on unfair terms have a mandatory character. Thus, parties may neither exclude their application nor vary their effects. Other issues of circumvention are addressed by way of interpretation of the individual provisions. For example, a standard term stating that the other party has confirmed that individual negotiations took place, is not sufficient to qualify the content of a contract term as having been negotiated (cf. comments to II.-9:403 (Meaning of “not individually negotiated”). It should be noted, that II.-9:401 only has an effect in favour of the party who did not supply an unfair term, and not of the supplier of the unfair term. This can be seen, for instance, in II.-9:409 (Effects of unfair terms) which provides that an unfair term “is not binding on the party who did not supply it”. Hence, the unfair term is binding on the party who supplied it.

II.-9:402: Duty of transparency in terms not individually negotiated

(1) Terms which have not been individually negotiated must be drafted and communicated in plain, intelligible language.

(2) In a contract between a business and a consumer a term which has been supplied by the business in breach of the duty of transparency imposed by paragraph (1) may on that ground alone be considered unfair.

This Article, which is modelled on Article 5, sentence 1 of the Unfair Terms Directive 1993/13/EEC requires that terms which have not been individually negotiated have to be drafted and communicated in plain, intelligible language. Thus, in the case of non-negotiated terms, the party supplying the terms assumes responsibility for their quality.

As a consequence, the supplier has to conceive the terms in a way that is sufficiently transparent for it to be possible for the other party to be familiar with the content of the contract before conclusion and to use the terms as a reliable source of information before and during the time of performance. The purpose of the Article is to ensure that the other party can figure out unaided the contractual rights and obligations from the contract terms.

While Article 5, sentence 1 of the Unfair Terms Directive 1993/13/EEC only refers to written terms, II.-9:402 does not contain such a limitation of scope. Therefore, II.-9:402 applies to all terms. It seems likely that Art. 5 of the Unfair Terms D. assumes that non-negotiated terms will only or mostly be in writing, whereas oral terms were envisaged only in the context of negotiations. Member State experience, however, demonstrates that non-negotiated oral terms actually exist. Since it is even more difficult to memorise oral terms, it seems more coherent to apply this provision to all terms instead of only to written terms (cf. also Recitals 11 and 20 of the Unfair Terms Directive 1993/13/EEC which also refer to non-written contracts).

The requirements of paragraph (1) are met if the other party can see from the contract and its terms what the contractual rights and obligations of the parties are. Consequently, the wording must be plain and intelligible. The same applies to the textual organisation, which must guarantee that the relevant terms can be recognised and identified without any unnecessary difficulty. Any information given by the terms has to be correct and complete so that no term is misleading.

Illustration 1

The standard terms used by landlord X state that in the winter, tenant Y may require “heating in the rooms used most frequently”. According to this term, it is unclear which rooms have to be heated. Assuming this situation cannot be resolved by interpretation, the term is not transparent. In consequence, heating has to be provided either in all rooms, or in those rooms to be heated under general rules.

While the scope of paragraph (1) is not limited to businesses, the standard for transparency may differ depending on whether the contract is between two business (B2B) or between a business and a consumer (B2C).

Illustration 2

In its terms for reservations, hotel company X limits refunds for cancellation to situations covered by “the recommendations of the national tourist and hotel association”. The term is unclear since the other party is unable to discover the scope of the right to a refund from the contract itself. The situation is different if the other party is a travel agency which can be expected to know the “recommendations”.

According to paragraph (2), in B2C relations, a contract term may be considered unfair for the sole reason that the term is not transparent. In consequence, if a term is supplied in breach of the duty of transparency imposed by paragraph (1) it is not binding on the party

who did not supply it, (see II.–9:409 (Effects of unfair terms)). II.–9:402 is complemented by II.–3:103 (Clarity and form of information) which requires that pre-contractual information must be clear and precise and provided in plain and intelligible language. Furthermore, II.–8:103 (Interpretation against party supplying term) states a *contra proferentem* rule for ambiguous contract terms which have not been individually negotiated.

II.–9:403: Meaning of “not individually negotiated”

(1) A term supplied by one party is not individually negotiated if the other party has not been able to influence its content, in particular because it has been drafted in advance, whether or not as part of standard terms.

(2) If one party supplies a selection of terms to the other party, a term will not be regarded as individually negotiated merely because the other party chooses that term from that selection.

(3) The party supplying a standard term bears the burden of proving that it has been individually negotiated.

(4) In a contract between a business and a consumer, the business bears the burden of proving that a term supplied by the business, whether or not as part of standard terms, has been individually negotiated.

(5) In contracts between a business and a consumer, terms drafted by a third person are considered to have been supplied by the business, unless the consumer introduced them to the contract.

Both the transparency rule in II.–9:402 (Duty of transparency of terms not individually negotiated) as well as the unfairness tests in II.–9:404 (Meaning of “unfair” in contracts between a business and a consumer) refers to terms “which have not been individually negotiated”. II.–9:403 provides a definition of a term that is “not individually negotiated” and sets up complementary burden of proof rules.

Paragraph (1) defines under which conditions a term is considered to be “not individually negotiated”. This provision is not limited to contract terms in a technical sense. Thus, terms in other instruments (e.g. powers of attorney, receipts) are covered as well.

Illustration 1

Supplier X requires potential customers to submit an “application form” which technically constitutes an offer. According to a term in this form, the customer is bound by the offer for three months. The term falls under II.–9:403 although technically, a term of an offer is not a contract term.

Illustration 2

A supplier uses a standard receipt form. Although, in most cases, a receipt does not constitute a contract, the text of the receipt may be subject to judicial control, e.g. concerning its transparency.

The definition is a negative one: a term supplied by one party has not been individually negotiated if the other party “has not been able to influence its content”. A party to a contract is able to exercise influence on a term if negotiations take place between the parties which offer a real opportunity to change the term. Thus, the crucial criterion is whether such real and meaningful negotiations took place. This requires an assessment of the substantial qualities of the negotiations which can be formalised only in part. In general, such negotiation not only requires a simple conversation about the term. The negotiation must offer a real chance to influence a contract term. Thus, it is usually an indication of the existence of real and meaningful negotiations if a term has in fact been substantially changed in the course of the negotiations.

Illustration 3

Supplier X offers to explain a certain term or terms to the other party. This is not sufficient for a negotiation. If however, after having read the supplier’s terms, the other party makes a counter-proposal for a certain term and the parties engage in a discussion about a compromise acceptable to both parties, the term is negotiated.

In order to be considered an “individually” negotiated term, the negotiation must have taken place between the individual parties. However, a single negotiation between the same parties will be sufficient to cover several uses of the same term if the relevant legal circumstances are similar.

Illustration 4

A contract is negotiated between consumer association X and business association Y. If a business Z uses this term, the term is not considered to be individually negotiated, merely because it was the subject of negotiations between X and Y. However, the courts may consider the collective bargaining when assessing the unfairness of the term pursuant to II.-9:404 (Meaning of “unfair” in contracts between a business and a consumer).

Illustration 5

Business X sells goods to business Y on the basis of a continuing business relationship. They always use the same standard contract. It will generally be sufficient if a term has been negotiated once.

Paragraph (1) gives some further guidance in this direction by indicating that a party is usually unable to influence the content of a term if the other party has drafted the term in advance, be it as part of standard terms or not. A term is drafted in advance, if its content is fixed by the user prior to the negotiations. The moment “prior to the negotiations” refers to the negotiations concerning the issue governed by the term; it does not necessarily refer to the whole negotiation process. This idea is complemented by paragraph (3) which contains a burden of proof rule according to which a party supplying a standard term bears the burden of proving that it has been individually negotiated. In addition, a standard term stating that the other party confirms that individual negotiations

took place is not sufficient to qualify the content of a contract term as having been negotiated.

Paragraph (2) further concretises the requirements for real and meaningful negotiations as explained above. According to this provision, a term will not be considered to be individually negotiated merely because it has been chosen from a “menu of terms” supplied by the other party. In such a case, the party supplying the terms usually does not give the other party a real opportunity to change the terms. The freedom to influence the content of the contract is limited to selecting one of several terms supplied by the other party.

Illustration 6

Insurance company X offers 5-year and 10-year contracts. The term is drafted in advance because the possible choices are defined by the supplier of the “menu of terms”. The situation is different if the insurance company leaves it to the customer to decide on the duration of the contract. For example, if the consumer may fill in a gap in a form and thereby choose the duration of the contract according to his or her preferences and the insurance company is willing to accept any duration, the duration is individually negotiated.

Paragraphs (1) and (2) are complemented by paragraphs (3) and (4) which deal with the burden of proving that a term has been individually negotiated. Paragraph (3) contains a general rule applicable regardless of the status of the parties, whereas paragraph (4) only applies to contracts between a business and a consumer. According to paragraph (3) the party supplying a standard term bears the burden of proving that this term has been individually negotiated. “Standard terms” (cf. the definition in Annex 1) are terms which have been formulated in advance for several transactions involving different parties, and which have not been individually negotiated by the parties. Thus the rule in paragraph (3) has to be read in the sense that if the term has been formulated in advance for several transactions involving different parties, the party who supplied it must prove that it has been individually negotiated. If this party fails to prove the individual negotiations, the term is considered to be a standard term. The burden of proof rule for standard terms is based on the assumption that the use of terms drafted in advance by one party for several transactions enabled the party supplying these terms to restrict the other party’s contractual freedom.

For relations between businesses and consumers paragraph (4) sets up an even stricter burden of proof rule. Here the business bears the burden of proving that a term supplied by the business has been individually negotiated regardless of whether the term is part of standard terms (thus has been drafted for several transactions) or not.

Both paragraphs (3) and (4) only address the matter of the burden of proof, i.e. determining which party has to present evidence and to bear the consequences of a remaining lack of factual certainty about individual negotiations. The standard of proof (e.g. preponderance of the evidence or judicial certainty) must be determined pursuant to the applicable procedural law.

Terms not individually negotiated can normally be attributed to one of the parties to a contract. However, it is possible that a third person (such as a notary) has drafted one or more of the terms. This situation is dealt with by paragraph (5). In order to prevent a circumvention of II.–9:403 this provision states that in contracts between a business and a consumer, terms drafted by a third person are considered to have been supplied by the business, unless the consumer introduced them to the contract. This provision is based on Article 3(2) of the Unfair Terms Directive 1993/13/EEC which generally refers to a “term which has been drafted in advance and the consumer has therefore not been able to influence the substance of the term”. Thus, under the Directive it does not matter whether the business introduced the term into the contract itself. Rather, in order to protect consumers, terms introduced by third parties are subject to control under the Directive.

II.–9:404: Meaning of “unfair” in contracts between a business and a consumer

In a contract between a business and a consumer, a term [which has not been individually negotiated] is unfair for the purposes of this Section if it is supplied by the business and if it significantly disadvantages the consumer, contrary to good faith and fair dealing.

This Article sets the standard for judicial control of terms in contracts between a business and a consumer. It is a highly controversial issue whether in B2C relations, the “content control” should only apply to terms which have not been individually negotiated or whether it should also cover individually negotiated terms. In the Acquis Principles prepared by the Acquis Group (which have been used as the model for these rules) the scope of the unfairness test is limited to non-negotiated terms. Thus, strictly speaking, the Acquis Group has only drafted rules on an unfairness test for non-negotiated terms, and has taken no position with regard to an unfairness control of individually negotiated terms. However, the majority of Study Group members wanted to extend this unfairness test to individually negotiated terms. Therefore, in the current version of II.–9:404 the words “which has not been individually negotiated” are put in square brackets. However, the practical consequence of this divergence is not to be overestimated considering the fact that II.–9:403 (Meaning of “not individually negotiated”) provides a very broad definition of what a not individually negotiated term is. The practical relevance of the distinction is reduced even further by the burden of proof rule in paragraph 4 of II.–9:403 according to which, in B2C contracts the burden of proving that a term has been individually negotiated is imposed upon the business.

More concrete criteria for the application of the unfairness test are provided in II.–9:408 (Factors to be taken into account in assessing unfairness). In addition, II.–9:407 (Exclusions from unfairness test) sets out the limits of the unfairness test. If a term is considered unfair under II.–9:404, according to II.–9:409 (Effects of unfair terms) it will not be binding upon the party who did not supply it.

In a more general perspective, II.–9:404 can be interpreted as a derivative of the general principle of good faith. It is thus related to other provisions referring to good faith, e.g. II.–3:301 (Negotiations contrary to good faith and fair dealing), III.–1:103 (Good faith

and fair dealing). II.–9:404 does not exclude an application of these other provisions. It may be that a term is generally in accordance with the requirements of good faith but invoking this term in a certain exceptional and unforeseeable situation is contrary to good faith. However, unfair results, even if limited to certain situations, constitute a strong argument that the term as such is contrary to the good faith requirement in II.–9:404, especially if changed wording of a term can easily exclude unfair effects of the term. Moreover, according to II.–9:404, the courts will also look at the circumstances at the time of the conclusion of the contract in order to determine the unfairness of the term.

II.–9:405: Meaning of “unfair” in contracts between non-business parties

In a contract between parties neither of whom is a business, a term is unfair for the purposes of this Section only if it is a term forming part of standard terms supplied by one party and significantly disadvantages the other party, contrary to good faith and fair dealing.

This Article sets the standard for judicial control of terms in contracts between parties, neither of whom is a business. This provision marks a sort of middle ground between the rather strict fairness test for B2C relations in II.–9:404 (Meaning of “unfair” in contracts between a business and a consumer) and the more liberal fairness test for B2B relations in II.–9:406 (Meaning of “unfair” in contracts between businesses). Consequently, II.–9:405 combines elements from both of the two other provisions.

The personal scope of II.–9:405 is defined in a negative way by the expression “parties neither of whom is a business”. The provision therefore applies to contracts e.g. between two consumers. It also applies to contracts between two non-profit organisations which are neither qualified as businesses nor as consumers, as the notion of consumers does not include legal persons. The scope of II.–9:405 is further limited to standard terms, i.e. terms which have been formulated in advance for several transactions involving different parties, and which have not been individually negotiated by the parties.

The criteria of the fairness test under II.–9:405 are identical to the criteria used in II.–9:404 (Meaning of “unfair” in contracts between a business and a consumer). Thus, the respective comments to II.–9:404 apply accordingly. However, it has to be borne in mind that in the cases covered by II.–9:405 the “content control” is not justified by the assumption of unequal negotiation power between a business and a consumer (as in II.–9:404) but by the assumption that the use of standard terms drafted in advance by one party enabled the party supplying these terms to restrict the other party’s contractual freedom. This difference in the justification of the judicial control may lead to a difference in the application of the unfairness test between II.–9:404 and II.–9:405.

More concrete criteria for the application of the unfairness test are provided in II.–9:408 (Factors to be taken into account in assessing unfairness). In addition, II.–9:407 (Exclusions from unfairness test) sets out the limits of the unfairness test. If a term is considered unfair under II.–9:405, according to II.–9:409 (Effects of unfair terms) it will not be binding upon the party who did not supply it.

II.–9:406: Meaning of “unfair” in contracts between businesses

A term in a contract between businesses is unfair for the purposes of this Section only if it is a term forming part of standard terms supplied by one party and of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing.

This Article sets the standard for judicial control of terms in contracts between businesses. Compared to the unfairness tests in II.–9:404 (Meaning of “unfair” in contracts between a business and a consumer) and II.–9:405 (Meaning of “unfair” in contracts between non-business parties) this is the most liberal of the three provisions on contractual “content control”. It is a controversial political issue in itself whether the judicial control of contract terms should be extended to B2B relations. Several Member States also have such control for B2B contracts. The *acquis communautaire* also seems to provide a basis for such an extension. While the Unfair Terms Directive 1993/13/EEC only applies to B2C contracts, Article 3(3) of the Late Payment Directive states the criteria for judicial control of certain terms in B2B contracts (“grossly unfair” with regard to “good commercial practice”). II.–9:406 reflects these guidelines by introducing limited “content control”.

As in the case of II.–9:405 (Meaning of “unfair” in contracts between non-business parties) the “content control” is not justified by the general assumption of unequal negotiation power between the parties – as in II.–9:404 (Meaning of “unfair” in contracts between a business and a consumer) – but by the assumption that the use of standard terms drafted in advance by one party enabled the party supplying these terms to restrict the other party’s contractual freedom.

The personal scope of II.–9:406 covers contracts between businesses, i.e. any natural or legal person, irrespective of whether publicly or privately owned, who is acting for purposes relating to the person’s self-employed trade, work or profession, even if the person does not intend to make a profit in the course of the activity. As in II.–9:405 (Meaning of “unfair” in contracts between non-business parties) the scope of II.–9:406 is limited further to standard terms, i.e. terms which have been formulated in advance for several transactions involving different parties, and which have not been individually negotiated by the parties. Thus, terms which have been formulated in advance by one of the parties but only for a single transaction, are not subject to the “content control” under II.–9:406.

The criteria of the fairness test under II.–9:406 are different from the criteria used in II.–9:404 (Meaning of “unfair” in contracts between a business and a consumer) and II.–9:405 (Meaning of “unfair” in contracts between non-business parties). While under these provisions a term is considered unfair if it “significantly disadvantages the other party, contrary to good faith and fair dealing”, II.–9:406 requires the term to “grossly deviate from good commercial practice, contrary to good faith and fair dealing”. The reference to “good faith and fair dealing”, which is the common element of the three unfairness tests, indicates that in all three cases the “content control” is a derivative of the general principle of good faith. Nevertheless, the standard applied under II.–9:406 is considerably different from the one used in II.–9:404 and II.–9:405. In effect, under II.–9:406 a term is

considered unfair only “if it grossly deviates from good commercial practice”. This standard is derived from Article 3(3) Late Payment Directive.

Illustration 1

According to the standard term of supplier A, a set-off against the claim of the supplier for payment is excluded. Whilst such a term would be presumed to be unfair in B2C cases under II.–9:411 (Terms which are presumed to be unfair in contracts between a business and a consumer) paragraph (1)(b), a set-off may be excluded in B2B contracts in order to prevent a buyer from invoking an unfounded set-off as a means to delay court proceedings. The buyer may raise separate court proceedings to enforce the right on which the set-off is based, which is no undue burden in B2B cases.

More concrete criteria for the application of the unfairness test are provided in II.–9:408 (Factors to be taken into account in assessing unfairness). In addition, II.–9:407 (Exclusions from the unfairness test) sets out the limits of the unfairness test. If a term is considered unfair under II.–9:405, according to II.–9:409 (Effects of unfair terms) it will not be binding upon the party who did not supply it.

II.–9:407: Exclusions from unfairness test

(1) Contract terms are not subjected to an unfairness test under this Section if they are based on:

- (a) provisions of the applicable law;***
- (b) international conventions to which the Member States are parties, or to which the European Union is a party; or***
- (c) these rules.***

(2) For contract terms which are drafted in plain and intelligible language, the unfairness test extends neither to the definition of the main subject matter of the contract, nor to the adequacy of the price to be paid.

This Article limits the scope of application of the unfairness test under the preceding three Articles. It contains two different exclusion rules. According to paragraph (1) contract terms which are based on statutory or international “background law” are excluded from the unfairness test. If a term is identical to a statutory provision or a provision in an international convention which is applicable to a contractual relationship, it does not make sense to control the term. If such a term were held invalid, the (identical) statutory provision or provision from a convention would apply. The unfairness tests in this Chapter give no power to control provisions of applicable law.

According to paragraph (2), the terms defining the subject matter and stating the price are excluded from the unfairness test. There are two reasons for this. First, judicial control of the quality of the goods or services as well as control of the adequacy of the price is incompatible with the needs of a market economy. Usually, the choice of the parties to enter into an exchange of goods and services for a certain price will be made individually

so that there is neither room nor need for judicial control. Secondly, such control would require an application of legal criteria which do not exist (for fixing the subject matter of a contract) or an inappropriate and potentially burdensome application of legal criteria which do exist but which are intended to be invoked only in very rare cases where these matters cannot be determined from the contract terms (see e.g. II.–9:104 (Determination of price) and II.–9:108 (Quality)). These criteria are not intended to be used every time one party claims that the contractually agreed terms on price or quality are unfair.

The situation is different, however, if the requirement of transparency is not met. In the case of terms which are insufficiently transparent, an informed market decision has not been made so that it is adequate to apply judicial control. Furthermore, there is an interest to eliminate terms lacking transparency in collective proceedings.

Illustration 1

In its terms, Bank X states that securities are sold at their actual price on the stock exchange with an additional commission of 1%. The term is not subject to a review of its content under II.–9:404 (Meaning of “unfair” in contracts between a business and a consumer) or II.–9:406 (Meaning of “unfair” in contracts between businesses). However, if the term is found intransparent, it can be reviewed under II.–9:402 (Duty of transparency in terms not individually negotiated) according to II.–9:407(2).

Paragraph (1) applies to terms which reflect an identical provision in a statutory or international instrument provided, however, that this provision would be applicable if the contract term did not exist. If this is the case, the term is not subject to the fairness test in this Section. In the case of international conventions, it is, therefore, not necessary for all Member States to be a party. It is sufficient that the convention is applicable because one or more Member States are a party. The provision applies to international conventions only, and not to private instruments.

Illustration 2

Airline X claims that its terms are based on the recommendations of the International Air Travel Association which are partly based on the Warsaw and Montreal Conventions. As far as the terms are identical to these conventions, the exception is applicable. This does not apply to other terms because a mere reflection of recommendations of a private association is insufficient.

It is not necessary for the statute or provision to be of a mandatory nature. Paragraph (1) only requires statutory or conventional “background law” which is identical to the contract terms so that the term is merely a restatement of an (otherwise applicable) provision or statute. Common law, customary law and case law have the same effect as statutes or conventions.

Paragraph (2) refers to the definition of the main subject matter of the contract or the adequacy of the price. The exception for subject matter of the contract means terms

which identify and describe the subject matter of the contract, i.e. (in most cases) the goods or services to be delivered.

Illustration 3

In its terms X, a seller of furniture, states that the colour of the furniture actually delivered may slightly differ from the colour seen in the seller's shop or catalogue. The term does not define the colour (and thereby, the delivered goods as the subject matter of the contract) but allows the seller to deviate from this definition. The term is subject to control.

The "main subject matter of the contract" refers to the obligation characteristic of the contract (cf. Art. 4(2) of the Rome Convention on the law applicable to contractual obligations). Since II.-9:407 is based on the theory that the main subject matter is individually negotiated, where the other party has made an individual choice that a certain object has been accepted, the provision applies only as far as this individual choice has not been altered or modified by the terms of the contract. Paragraph (2) requires a distinction between the definition of the subject matter and terms which alter subject matter already defined by the parties. Whereas the former falls under paragraph (2), the latter does not. Paragraph (2) moreover, does not apply to the terms dealing with the legal effects of a definition, e.g. terms limiting the effect of a contractual warranty.

The same principles apply to terms determining the price.

Illustration 4

In its terms, a manufacturing company states that the price will be determined according to its newest price list after the conclusion of the contract. The term is subject to control because it gives the manufacturer the right to change the price unilaterally.

II.-9:408: Factors to be taken into account in assessing unfairness

(1) When assessing the unfairness of a contractual term for the purposes of this Section, regard is to be had to the duty of transparency under II.-9:402 (Duty of transparency in terms not individually negotiated), to the nature of the goods or services to be provided under the contract, to the circumstances prevailing during the conclusion of the contract, to the other terms of the contract and to the terms of any other contract on which the contract depends.

(2) For the purposes of II.-9:404 (Meaning of "unfair" in contracts between a business and a consumer) the circumstances prevailing during the conclusion of the contract include the extent to which the consumer was given a real opportunity to become acquainted with the term before the conclusion of the contract.

A. General principle and scope

This Article provides the criteria for the unfairness tests contained in II.–9:404 (Meaning of “unfair” in contracts between a business and a consumer), II.–9:405 (Meaning of “unfair” in contracts between non-business parties) and II.–9:406 (Meaning of “unfair” in contracts between businesses). While these provisions define the standard of fairness, i.e. “good faith and fair dealing” in II.–9:404, II.–9:405 and “good commercial practices” in II.–9:406, the present Article determines which factors have to be taken into account in assessing unfairness. Paragraph (1) contains a general rule which is applicable to all three unfairness tests mentioned above. Paragraph (2) concretises this rule for the unfairness test under II.–9:404, which is applicable for contracts between a business and a consumer.

B. Factors to be taken into account for all contracts

The list of factors to be taken into account when assessing the unfairness of a contract term is based on Article 4(1) Unfair Terms Directive 1993/13/EEC, and it has been clarified that the transparency of the term is also included as a factor. It has to be borne in mind that the starting point and the subject of the unfairness test is an abstract assessment of the relevant single term in question and not on “overall acceptability” of the contract as a whole. Nevertheless, other terms of the contract and terms of any other contracts on which the contract depends are also included into the assessment. This approach, however, may not compromise the principle that the subject of control is each individual term. Thus, in principle, each term has to be considered separately. An “overall acceptability” of the contract as a whole is irrelevant. Consequently, the supplier of terms is not allowed to justify an unfair term by including other terms which are favourable to the other party unless there is a close connection between the subject matter of both terms so that the favourable term constitutes an effective compensation. In particular, a low price cannot justify unfair terms unless this arrangement is the result of an individual negotiation. In summary, the reference to other terms in paragraph (1) only means that the effect of one term may be influenced by other terms.

As the unfairness test starts from an abstract assessment of an individual term, the “circumstances prevailing during the conclusion of the contract” might only influence the result of the test in exceptional cases. For instance, if the abstract fairness test has the result that the term in question lies on the borderline between fair and unfair, the term may be considered as ‘only just’ fair, if the party supplying the term has made a particular effort to explain the consequences of the term to the other party.

C. Additional rule for contracts between a business and a consumer

According to paragraph (1) when assessing the unfairness of a contract term regard is to be had to the duty of transparency under II.–9:402 (Duty of transparency in terms not individually negotiated). Thus, one of the factors to be taken into account is whether the term has been drafted in plain, intelligible language. This question has to be distinguished from the question regulated in paragraph (2), according to which (in consumer cases), another relevant factor is the extent to which the consumer was given a real opportunity

to become acquainted with the term before the conclusion of the contract. This rule is based on several provisions of the *acquis communautaire*, in particular, Annex I (i) Unfair Terms Directive 1993/13/EEC, Article 4(2)(b) Package Travel Directive, Article 3 Cross-Border Credit Transfers Directive and Article 5 Financial Services Distance Selling Directive, which confirm that this aspect is a key fairness requirement (at least) in B2C contracts.

Paragraph (2) stipulates an intensification of the general rule in II.–9:103 (Terms not individually negotiated), according to which the supplier of non-negotiated terms has to draw the other party's attention to the terms before the conclusion of the contract. Paragraph (2) of II.–9:408 (Factors to be taken into account in assessing unfairness) requires the business to do more, namely to give the consumer a real opportunity to become acquainted with the term.

Illustration 1

In a shop, there is a clear reference to the standard terms available at the cash desk. A copy of these terms is attached to the cashier's desk. It is only possible for the consumer to read these when standing immediately next to the cashier and not while waiting in line. Once the consumer has reached the cashier, there is not enough time to read the terms, since there are other clients waiting behind. The requirements of the general incorporation rule in II.–9:103 (Terms not individually negotiated) are met, because the supplier has drawn the other party's attention to the terms before the conclusion of the contract. But the requirements of paragraph (2) of II.–9:408 (Factors to be taken into account in assessing unfairness) are not met.

It should be noted that the consequences of II.–9:103 (Terms not individually negotiated) and of II.–9:408 (Factors to be taken into account in assessing unfairness) paragraph (2) are different. If the supplier of the terms does not take reasonable steps to draw these terms to the attention of the other party, the supplier may not invoke the terms against the other party. Thus, the terms are not part of the contract unless the other party so desires. However, if the business takes reasonable steps to draw the attention of the consumer to the terms, but the consumer is not given a real opportunity to become acquainted with the term, the terms become part of the contract. Nevertheless, the lack of this opportunity is a factor which has to be taken into account when assessing whether a term is to be considered unfair.

Under II.–9:408 (Factors to be taken into account in assessing unfairness) paragraph (2) the supplier has to ensure that the consumer actually takes notice of the terms and has a real opportunity to read them. A real opportunity to read is both necessary and sufficient. Whether the consumer takes this opportunity or not is irrelevant.

Illustration 2

An online shop offers mobile phones to private customers. The active website shows a hyperlink to standard terms prior to the conclusion of the contract. It accepts orders only if the consumer confirms that the standard terms have been read. Customer B confirms that they have been read but actually has not read

them. The requirements of paragraph (2) are met although B's confirmation was incorrect. B had a real opportunity to read the terms.

The requirement of a real opportunity relates to all aspects relevant to this opportunity, especially to the availability and readability of the terms. In most cases, it will be necessary to provide a readable print version of the terms prior to the conclusion of the contract and to give the consumer enough time to carefully read the terms.

Illustration 3

In a department store, the standard terms are posted on the wall right beside the cashier so that it is impossible to overlook them and consumers have a good opportunity to read them. In this case, the requirements of paragraph (2) are met.

If a term is used for several contracts in a continuing relationship between the same parties who always use the same standard contract, it will generally be sufficient if the consumer had a real opportunity to become acquainted with the term at the beginning of the relationship.

II.-9:409: Effects of unfair terms

(1) A term which is unfair under this Section is not binding on the party who did not supply it.

(2) If the contract can reasonably be maintained without the unfair term, the other terms remain binding on the parties.

A. Purpose and scope

The provision states the legal effects of unfairness on contracts. Paragraph (1) deals with the effect of unfairness on the term itself. It follows a unilateral solution, according to which the other party is not bound to an unfair term whereas the supplier is. This means that it is for the other party to decide whether the term, regardless of its unfairness, should be applied or not. Paragraph (2) deals with the effects of paragraph (1) on the remaining contract. The contract is binding for both parties if it can be maintained without the unfair term. It is the purpose of this provision simply to strike out the unfair term so that the other side is not deprived of the advantages of a contract and to maintain the remaining contract as far as this is possible.

B. Effect of unfairness on the term considered unfair

According to paragraph (1), a term which is unfair is not binding for the other party, i.e. the party who did not supply it. Not binding means that no legal effects can be based on such a term: neither any rights against the other party nor any exclusion or limitation of rights or defences of the other party.

Illustration 1

In its sales terms, a seller excludes all rights of the buyer in cases of a defect except for the right to terminate the contractual relationship. A right to terminate, even without giving the seller an opportunity to cure the defect, is however expressly conferred by the term. The term is not binding on buyers, even in B2B contracts, since it excludes all rights to claim damages even in cases of gross negligence or even intent. A buyer gives notice of termination. The seller invokes the unfairness of the term, arguing that the buyer has no rights to terminate under it and must allow an opportunity for repair or replacement. According to II.–9:409(1), the seller is barred from invoking the unfairness of its own terms. The term is binding on the seller.

Illustration 2

Based on the same circumstances as in Illustration 1 but the defect was caused by the seller's negligence. As a consequence of the defect, the buyer could not resell the goods to a third party. The buyer may claim damages for lost profits from the seller. The unfair term is not binding on the buyer.

The provision can operate without any further definitions of “not binding”. Not binding “on a party who did not supply them” means that the term has no legal effect against this party whereas it may be invoked against the supplier of the term, if the other party so desires. Thus, the other party, especially a consumer, has no obligation to invoke the non-binding effect in a legal proceeding. However, as stated by the ECJ in *Océano Grupo* (C-240/98 to C-244/98), *Cofidis* (C-473/00) and *Mostaza Claro* (C-168/05), a consumer has to be protected, even if he or she fails to raise the unfair nature of the term, either because unaware of available rights or because deterred from enforcing them. Therefore, if the consumer does not take an explicit decision as to whether to be bound to the term or not, courts have to decide on their own accord about the consequences of unfairness.

C. Effect of unfairness on the remaining contract

According to paragraph (2), a contract can be maintained without the unfair term if the content of the remaining contract without the term is legally viable. This may be the case because the term addresses a question which does not need a contractual answer either because the question is not essential or because there is a default rule or statutory background provision to fill the gap. The non-binding effect is thus as a rule limited to the unfair term. Consequently, it is no defence against a binding effect of the remaining contract that the remaining contract is less advantageous for the supplier. It is up to the supplier to supply adequate terms in order to avoid this effect.

Illustration 3

X buys goods from seller Y. The standard terms of Y include a general and unlimited right for the seller to change the price stated in the contract. The term is not binding. The contract, however, can be maintained without the unfair term. The seller may not claim that it is more burdensome to be bound at the initial price and that the contract would not have been concluded without the invalid

term: there may be an exception when doctrines of general contract law, e.g. good faith because of hardship, apply.

A contract cannot be maintained without the unfair term if this term is essential for the contract and cannot be supplied by reference to default rules or background provisions.

II.-9:410: Exclusive jurisdiction clauses

(1) A term in a contract between a business and a consumer is unfair for the purposes of this Section if it is supplied by the business and if it confers exclusive jurisdiction for all disputes arising under the contract on the court for the place where the business is domiciled.

(2) Paragraph (1) does not apply if the chosen court is also the court for the place where the consumer is domiciled.

A. Background and scope

This Article is based on the ECJ's judgment in C-240/98 – *Oceano Grupo*, according to which a term conferring exclusive jurisdiction for all disputes arising under a contract between a business and a consumer on the court for the place where the business is domiciled, is unfair under Article 3 of the Unfair Terms Directive 1993/13/EEC.

The Article does not address the procedural admissibility of jurisdiction terms. It only deals with the question of their contractual validity. It applies to jurisdiction terms which are included in a contract as well as to separate agreements. It does not distinguish between terms addressing international jurisdiction and those addressing local jurisdiction or venue. If the term provides for the jurisdiction at the domicile of the business, it is regarded as unfair.

B. Relation to other jurisdictional terms and Brussels I Regulation

The provision does not exclude other jurisdictional terms, e.g. terms giving jurisdiction to another remote forum, from falling under II.-9:405, II.-9:406 and II.-9:411 lit. (p). The same may apply to arbitration clauses (cf. ECJ C-168/05 – *Elisa María Mostaza Claro v. Centro Móvil Milenium SL*).

In international cases, Articles 15 to 17 of the Brussels I Regulation may apply. According to Art. 17, a business may enter into a jurisdictional agreement with a consumer (i) if it is concluded after the dispute has arisen; (ii) if it allows the consumer to bring proceedings in courts other than those indicated in Art. 15 or 16 of the Brussels I Regulation; (iii) or if it is entered into by both the consumer and the other party within the contract, both of whom at the time of conclusion of the contract are domiciled or habitually resident in the same Member State on whose courts jurisdiction is conferred,

provided that such an agreement is not contrary to the law of that Member State. As the wording of paragraph (1), only leaves room for cases (i) and (ii), paragraph (2) clarifies that a jurisdiction term stipulating case (iii) is also not prohibited by this provision.

Illustration 1

In its standard terms for consumer contracts, business A states: “All disputes arising from or in the context of this contract are subject to the exclusive jurisdiction of the courts of our domicile”. The term is invalid.

Illustration 2

In contracts used for consumers domiciled in the same Member State X as the business, a term states: “All disputes arising from or in the context of this contract are subject to the exclusive jurisdiction of the courts of X.” The term does not give preference to the courts at the domicile of the business; it only assures that the courts of State X still have jurisdiction if the consumer leaves the country after the conclusion of the contract. The term is valid.

II.–9:411: Terms which are presumed to be unfair in contracts between a business and a consumer

(1) A term in a contract between a business and a consumer is presumed to be unfair for the purposes of this Section if it is supplied by the business and if it:

- (a) excludes or limits the liability of a business for death or personal injury caused to a consumer through an act or omission of that business;*
- (b) inappropriately excludes or limits the remedies, including any right to set-off, available to the consumer against the business or a third party for non-performance by the business of obligations under the contract;*
- (c) makes binding on a consumer an obligation which is subject to a condition the fulfilment of which depends solely on the intention of the business;*
- (d) permits a business to keep money paid by a consumer if the latter decides not to conclude the contract, or perform obligations under it, without providing for the consumer to receive compensation of an equivalent amount from the business in the reverse situation;*
- (e) requires a consumer who fails to perform his or her obligations to pay a disproportionately high amount of damages;*
- (f) entitles a business to withdraw from or terminate the contractual relationship on a discretionary basis without giving the same right to the consumer, or entitles a business to keep money paid for services not yet supplied in the case where the business withdraws from or terminates the contractual relationship;*
- (g) enables a business to terminate a contractual relationship of indeterminate duration without reasonable notice, except where there are serious grounds for doing so; this does not affect terms in financial services contracts where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof immediately;*
- (h) automatically extends a contract of fixed duration unless the consumer indicates otherwise, in cases where such terms provide for an unreasonably early deadline;*

(i) enables a business to alter the terms of the contract unilaterally without a valid reason which is specified in the contract; this does not affect terms under which a supplier of financial services reserves the right to change the rate of interest to be paid by, or to, the consumer, or the amount of other charges for financial services without notice where there is a valid reason, provided that the supplier is required to inform the consumer at the earliest opportunity and that the consumer is free to terminate the contractual relationship with immediate effect; neither does it affect terms under which a business reserves the right to alter unilaterally the conditions of a contract of indeterminate duration, provided that the business is required to inform the consumer with reasonable notice, and that the consumer is free to terminate the contractual relationship;

(j) enables a business to alter unilaterally without a valid reason any characteristics of the goods or services to be provided;

(k) provides that the price of goods is to be determined at the time of delivery, or allows a business to increase the price without giving the consumer the right to withdraw if the increased price is too high in relation to the price agreed at the conclusion of the contract; this does not affect price-indexation clauses, where lawful, provided that the method by which prices vary is explicitly described;

(l) gives a business the right to determine whether the goods or services supplied are in conformity with the contract, or gives the business the exclusive right to interpret any term of the contract;

(m) limits the obligation of a business to respect commitments undertaken by its agents, or makes its commitments subject to compliance with a particular formality;

(n) obliges a consumer to fulfil all his or her obligations where the business fails to fulfil its own;

(o) allows a business to transfer its rights and obligations under the contract without the consumer's consent, if this could reduce the guarantees available to the consumer;

(p) excludes or restricts a consumer's right to take legal action or to exercise any other remedy, in particular by referring the consumer to arbitration proceedings which are not covered by legal provisions, by unduly restricting the evidence available to the consumer, or by shifting a burden of proof on to the consumer.

(2) Subparagraphs (g), (i) and (k) do not apply to:

(a) transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate beyond the control of the business;

(b) contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in foreign currency.

A. Background and general scope

This Article contains a list of terms which would typically constitute a serious disadvantage for a consumer. Therefore these terms are presumed to be unfair in contracts between a business and a consumer if such a term is supplied by the business. The purpose of the non-exhaustive list is to give examples of terms which are typically unfair under II.-9:404 (Meaning of "unfair" in contracts between a business and a

consumer). Apart from some minor linguistic variations, the list is more or less a restatement of the Annex of the Unfair Terms Directive 1993/13/EEC with two notable exceptions: Firstly Annex 1 lit. (i) has been dropped from the list, since this provision is sufficiently reflected in II.–9:408(2). Secondly, some of the exceptions in Annex 2 to the Directive have been shifted to the terms to which they refer.

B. “Grey list” instead of “indicative list” or “black list”

The general character of the list has been changed. Whereas the list in the Annex of Directive 1993/13/EEC is only indicative, the list in the present Article DCFR is, following the model of several Member States, a “grey list” of terms which are presumed to be unfair. It is a political question, whether it would even be better for some of the items on this “grey list” to be placed on a “black list” in the sense that such a term cannot be justified by any means and is thus invalid even in very exceptional cases. A candidate to be blacklisted could be a term that excludes or limits the liability of a business for death and personal injury caused to a consumer (cf. paragraph (1)(a)). But this example shows that there must be exceptions (e.g. terms limiting strict liability under the law on non-contractual liability for damage). Therefore these model rules do not blacklist terms except in the single case of II.–9:410 (Exclusive jurisdiction clauses) which goes back to a clear ECJ judgment. But even this very short “black list” with only one item on the “list” in II.–9:410 (Exclusive jurisdiction clauses) proves the disadvantages of such a rigid approach, as it became necessary to spell out the exception in paragraph (2). As a result, the “grey list”, which is only presumptive, generally seemed the favourable and more flexible approach even for those cases where terms can be justified only in very exceptional cases.

C. List of examples

The list of examples of unfair terms contains *inter alia* terms that exclude the business’s liability in cases of personal injury inflicted by the business or a limitation or inclusion of important contractual remedies in cases of non-performance or terms that give complete control to the business over the “if” and “how” of the performance.

Illustration 1

According to its standard terms, business A limits its liability to cases of intention and gross negligence. The term applies to all kinds of damage so that cases of death or personal injury are included. The term falls under II.–9:411(1)(a) since X excludes its liability for death and personal injury in cases of simple negligence.

Illustration 2

The standard terms of bus company B state that scheduled journeys are subject to cancellation without prior notice. The terms are meant to apply even if a passenger has a ticket with a reservation for a certain journey. II.–9:411(1)(c) applies because the right to cancel is not limited to certain cases such as force majeure, impossibility etc.

Illustration 3

Electrician C provides electrical installations for private homes. In order to be compensated for the effort of initially estimating the costs, C's terms state in a sufficiently transparent manner that a down-payment is required for the costs of an estimate and that it will not be refunded if no contract is concluded. If asked to estimate for a certain project, C informs potential customers about this term but refuses to enter into any negotiations about this issue. Technically, the term falls under II.-9:411(1)(d) since the electrician can keep money paid by the consumer without giving the consumer the equivalent right in the reverse situation. However, under these circumstances it is clear for a consumer that an estimate is not available for free. Although the term technically constitutes a non-negotiated term, the situation is similar to free consent. The consumer is sufficiently informed about the costs of the estimate and agrees to these terms in a way which is similar to a separate contract. Provided that this is the case, the term may be considered acceptable although it falls under II.-9:411(1)(d).

Even if a term does not fall under one of the examples contained in II.-9:411 the list of examples may provide some guidance when assessing whether a term is to be considered unfair under II.-9:404 (Meaning of "unfair" in contracts between a business and a consumer") as the examples in II.-9:411 may be considered as statements of more general fairness principles.

Illustration 4

The terms of a package travel company state that tourists may be excluded from the package tour if one of the providers (e.g. hotel or transportation) asks the package travel company to do so. The term does not fall under II.-9:411(1)(g) since a package travel tour does not constitute a contract of indeterminate duration; nor is the term covered by any other subparagraph of II.-9:411. However, II.-9:411(1)(g) may be seen as a statement of the principle that a termination of a contractual relationship requires a sufficient reason, adequate under the circumstances. The mere wish of one of the providers is not sufficient for this purpose: so that the term should be held unfair under II.-9:404 (Meaning of "unfair" in contracts between a business and a consumer").

C. Interpretation of the examples

Some of the examples listed in II.-9:411 comprise terms which require judicial discretion, e.g., "reasonable", "unreasonable", "valid reason", "disproportionate" or "inappropriate". In such a case, judicial discretion can only exist in a "weaker sense" (for this term see *Dworkin*, *Taking Rights Seriously*, Cambridge/Mass. (1978), p. 31), which means that judges must not follow their personal subjective standards but develop reliable objective case law in order to give meaning to these provisions.

Illustration 5

The standard terms of seller A state that "a set-off against our claims is excluded, unless it is based on a counterclaim recognised by a final court decision". The question whether this term is covered by II.-9:411(1)(b) depends on an interpretation of the word "inappropriately" in this provision. The courts have to

develop a reliable case law for the interpretation of this term. In this context, courts should consider that there are other cases where the existence of a counterclaim is obvious, e.g. if the seller does not dispute the counterclaim or if the seller's defences against the counterclaim are obviously unfounded. Therefore, such a term should be considered to be contrary to II.-9:411(1)(b).

BOOK III

OBLIGATIONS AND CORRESPONDING RIGHTS

CHAPTER 1: GENERAL

III.-1:101: Definitions

- (1) An obligation is a duty to perform which one party to a legal relationship, the debtor, owes to another party, the creditor.*
- (2) Performance of an obligation is the doing by the debtor of what is to be done under the obligation or the not doing by the debtor of what is not to be done.*
- (3) Non-performance of an obligation is any failure to perform the obligation, whether or not excused, and includes delayed performance and any other performance which is not in accordance with the terms regulating the obligation.*
- (4) An obligation is reciprocal in relation to another obligation if:*
- (a) performance of the obligation is due in exchange for performance of the other obligation;*
 - (b) it is an obligation to facilitate or accept performance of the other obligation; or*
 - (c) it is so clearly connected to the other obligation or its subject matter that performance of the one can reasonably be regarded as dependent on performance of the other.*
- (5) The terms regulating an obligation may be derived from a contract or other juridical act, the law or a legally binding usage or practice, or a court order; and similarly for the terms regulating a right.*

COMMENTS

A. General

This Chapter moves from rules relating to contracts and other juridical acts to rules relating to obligations and corresponding rights to performance. The obligations and corresponding rights must be within the intended scope of the model rules but, as is made clear by the next Article, need not arise from a contract. The first Article contains some essential definitions.

B. “Obligation”

It is necessary to define “obligation” because in national laws and legal literature the word is used in at least two senses. Sometimes it is used, as here, as the correlative of a

right to performance – the debtor’s side of the legal relationship between the debtor and the creditor. The expression “rights and obligations” is found very frequently. Sometimes the word “obligation” is used to denote the whole legal relationship between the debtor and the creditor. This usage, although traditional and eminently respectable, appears to be less frequent in modern European and international legal instruments. The Principles of European Contract Law, for example, use “obligation” predominantly in the first sense. An obligation is performed or not performed. One does not perform a relationship. The important thing from the drafting point of view is to make a clear choice and stick to it. Paragraph (1) of the Article defines “obligation” in the first of the two senses mentioned.

Under the definition in paragraph (1) an obligation presupposes a legal relationship and is owed to a particular creditor. This is one of the features which distinguishes an obligation from a duty under these rules. A person has a duty if that person is bound to do something, or expected to do something, in accordance with an applicable normative standard of conduct (see Annex 1). A duty does not presuppose a legal relationship and need not be owed to a particular creditor. There can, for example, be a duty to be a good citizen or a duty not to cause harm to others without justification but these would not be obligations in the sense in which the word is used here. Another difference is that there is normally, in principle, a remedy for non-performance of an obligation. Unless otherwise stated, the normal remedies for non-performance are available. There is not necessarily a remedy or sanction for a breach of a duty. It follows that when these rules impose a duty, rather than an obligation, they state the sanction, if any, for breach of the duty. The normal remedies for non-performance of an obligation will not automatically apply.

References to a “debtor” in these rules are to a person who owes an obligation, whether or not the content of the obligation is the payment of money (a monetary obligation). This in turn makes it possible, without risk of misunderstanding, to use the words “debtor” and “creditor” in later provisions rather than “obligor” and “obligee”, which are not common English words and which can be confusing.

It will be a question of wording and of interpretation whether a particular statement gives rise to an obligation or is merely a representation (which might nonetheless give rise to various remedies if it is false). A statement relating to the conformity of x to y might, for example, be a simple representation that x does in fact conform to y, or the undertaking of an obligation to ensure that x does conform to y, or the undertaking of an obligation to pay a certain sum if x does not conform to y.

C. “Performance”

The main purpose of this definition is to remove a possible doubt as to whether “performance” can apply only to an obligation to do something, with some word like “forbearance” being used for an obligation not to do something. The definition makes it clear that “performance” covers both positive and negative obligations.

D. “Non-performance”

Under the system adopted in these rules non-performance of an obligation is any failure to perform the obligation. There is a unitary concept of non-performance. In the case of an obligation to receive or accept the other party's performance the failure to perform may take the form of refusing to accept the performance. Non-performance is not limited to total failure to perform. The non-performance may consist in a defective performance (i.e. a performance which does not conform to the terms regulating the obligation) or in a failure to perform at the time performance is due, be it a performance which is effected too early, too late or never.

Non-performance is used of any non-performance whether or not excused. The consequence of this is that when a remedy is available only for a non-excused non-performance this has to be made clear.

Whether or not there is non-performance will depend on the terms regulating the obligation and on the facts. A distinction is often made between an obligation to achieve a particular result (“*obligation de résultat*”) and an obligation to make reasonable efforts to do something or use reasonable skill or take reasonable care in doing something (“*obligation de moyens*”). In the latter case there will be a non-performance only if reasonable efforts are not made, or reasonable skill or care is not taken. Many variations are possible as to the degree of effort, care or skill required.

E. “Reciprocal”

Some rules apply, and some remedies for non-performance are available, only in the case of reciprocal obligations. This is the case for the rules on the order of performance and for the remedy of withholding performance. In the contractual context the notion of reciprocal obligations is also important in the remedy of termination for fundamental non-performance. Generally speaking, however, the relevant distinction here is not between contractual and non-contractual obligations. It would be wrong to suppose that all contractual obligations are reciprocal and all non-contractual obligations are not reciprocal. There can be a contract in which only one party has obligations, the other party being not even obliged to accept performance. And there can be a contract in which there are different packages of obligations, the obligations of one party in one package not being reciprocal to the obligations of the other party in another package. Conversely, there can be reciprocal obligations which arise under separate contracts in an inter-related series of contracts between the same parties. There may even be cases where a non-contractual obligation and a contractual obligation may be reciprocal. For example, an obligation under a unilateral promise may be the counterpart of an obligation under a contract. And there can be cases where two non-contractual obligations are reciprocal. For example both parties may be enriched and disadvantaged by the same void contract. Both may be under an obligation to reverse the relevant enrichment. Each obligation is the counterpart of the other. In short, reciprocal obligations need not both be contractual and, if contractual, need not both arise from the same contract

It should not be assumed that it is only in the case of complicated commercial transactions that there can be a mixture of inter-related contractual and non-contractual obligations. This is often so in the case of ordinary consumer transactions. One common example is the combination of rights and obligations under a unilateral guarantee and rights and obligations under a related contract. Another might be, depending on the actual terms, the common marketing device announced by the slogan “Buy one. Get one free.” Whatever the economic reality of such a situation, it may in certain cases have to be analysed legally as a combination of a contract and a unilateral undertaking, with reciprocal obligations under each. And consumers may be affected by reciprocal non-contractual obligations. For example, if a consumer avoids a contract the law on unjustified enrichment may give rise to reciprocal obligations between the consumer and the business.

The definition of “reciprocal” covers not only an obligation performance of which is due in exchange for performance of the first obligation but also an obligation to facilitate or accept performance of the first obligation and an obligation which is so clearly connected to the other obligation or its subject matter that performance of the one can reasonably be regarded as dependent on performance of the other. Examples of this last category might be an obligation to do something only if the other party performs an obligation to supply certain information or pay certain expenses or return certain property. One typical case is where there is an obligation to return property only if certain costs related to keeping it and protecting it from damage are paid.

F. “Terms regulating an obligation”

The only reason for having this definition is that the expressions “terms regulating an obligation” or “terms regulating a right” are not so familiar as “terms of a contract” and may cause some initial uncertainty. The definition makes it clear that the terms regulating an obligation or a corresponding right may be derived from a contract or other juridical act, from a law, from a court order or from a legally binding usage or practice.

III.–1:102: Scope of Book

This Book applies to obligations within the scope of these rules, whether they are contractual or not, and to corresponding rights to performance.

COMMENTS

A. Limited scope

The scope of this Book is limited by the intended field of application of these rules as a whole. This means that it is not intended to apply, for example, to public law rights and obligations, to family law rights and obligations, to employment law rights and obligations or to land law rights and obligations. Many non-contractual obligations – for example, obligations to pay taxes or social security contributions, or obligations to submit

reports and returns – are of a public law nature and therefore beyond the intended scope of these rules. The legislation imposing the obligations can be expected to regulate the modalities of performance and the consequences of non-performance. Of course, there is nothing to stop a legislator, when imposing an obligation of any kind, from adopting rules similar to those in this Book or from making provision by reference or analogy on such matters as place of performance and time of performance and the remedies for non-performance. But the intended field of application of this Book is what might be called traditional obligations of a patrimonial law nature in the field of private law, and corresponding rights.

Not all legal systems commonly refer to all such obligations by that name. They may, for example, speak of “liability” to pay damages for loss caused to another rather than “an obligation” to do so. But in practice the modalities of the liability – for example, where the damages must be paid, or whether interest is payable – are then governed by the same rules, or close parallels to them, as apply to contractual obligations. It seems better to use the one word “obligation” in relation to all cases in which, as a matter of private law, a person must render a performance of some kind to another.

B. Obligations, rather than duties

The Book does not contain general rules on duties, as opposed to obligations. So, for example, the normal rules on non-performance of an obligation do not apply to a breach of the moral duty not to harm other people, intentionally or negligently, without justification. It is only when legally relevant damage has occurred that an obligation to make reparation arises. The circumstances in which the obligation does arise are set out in the Book on non-contractual liability for damage caused to another. The way in which the obligation falls to be performed is also regulated where necessary in that Book but some aspects do not need to be regulated there because they are covered by the general rules in this Book.

C. Obligations, rather than contractual obligations

There are good reasons for not applying this Book only to contractual obligations and corresponding contractual rights. It is not only contractual obligations which must be performed and which may not be performed. It is not only contractual rights which prescribe after a certain length of time. It is not only contractual rights which can be assigned. In many situations the legal relations between two or more parties will be composed of a mixture of mutual rights and obligations, not all of them arising from a contract. Rules are necessary in relation to all types of obligations. This was already recognised in the Principles of European Contract Law where, in spite of the name, many of the Articles, particularly in Part III, apply to rights and obligations in general.

The obligations to which this Book applies include, for example, obligations arising out of unilateral promises or undertakings, pre-contractual obligations, obligations arising by operation of law to pay damages for loss caused to another, obligations arising by operation of law out of benevolent intervention in another’s affairs, and obligations

arising by operation of law to reverse an unjustified enrichment. In the last case the obligations will generally be to return property or pay a monetary equivalent. In all of these cases questions may arise about the modalities of performance. When and where, for example, must an obligation to reverse an enrichment be performed? And in all of them questions may arise about the meaning of, and remedies for, non-performance. Sometimes these matters are dealt with specifically in the relevant places but it is advantageous not to have to repeat default rules of a standard type in every provision for a non-contractual obligation.

There are, however, a few provisions which apply only to contractual obligations. These are clearly identified. Of course, such specific provisions prevail over the general rule. (I.-1:102 (Interpretation and development) paragraph (5).)

III.-1:103: Good faith and fair dealing

(1) A person has a duty to act in accordance with good faith and fair dealing in performing an obligation, in exercising a right to performance, in pursuing or defending a remedy for non-performance, or in exercising a right to terminate an obligation or contractual relationship.

(2) The duty may not be excluded or limited by contract.

(3) Breach of the duty does not give rise directly to the remedies for non-performance of an obligation but may preclude the person in breach from exercising or relying on a right, remedy or defence which that person would otherwise have.

COMMENTS

A. Good faith and fair dealing

This Article sets forth a basic principle. Good faith and fair dealing are required in the performance of obligations, in the exercise of rights to performance, in pursuing or defending remedies for non-performance or in exercising a right to terminate an obligation or contractual relationship.

As will appear from the Notes, a general duty of good faith is not recognised in the laws of all Member States. However, those that do not recognise it explicitly frequently have specific rules which produce very similar results. This justifies the adoption of a general duty of good faith and fair dealing in these rules. Nonetheless drafters of European legislation should note that in the laws that do not recognise a general duty of good faith, the legislation will not be reinforced by such a duty and the courts may not always readily develop specific rules to achieve the same result. If it is desired that a legislative rule should be supported by a requirement that the parties act in good faith, for example to prevent evasion of the rule, it may be wise to spell this out in the legislation itself, or to include specific provisions to prevent at least those forms of evasion that can be foreseen.

The Article uses the word “duty” rather than “obligation” because of the rather vague, supplementary and all-pervasive nature of what is expected from the parties and because the ordinary remedies for non-performance of an obligation are not directly available – although they may be indirectly available if the principle of good faith and fair dealing gives rise to a tacit or implied term of a contract. See paragraph (3).

B. Nature of the duty

The composite expression "good faith and fair dealing" is intended to indicate that what is in issue here is an objective standard of conduct. “Good faith” on its own might refer to a subjective state of mind. Legal rules sometimes use “good faith” in this subjective sense. For example, a certain result may follow only if a purchaser has acquired goods in good faith, without notice of third-party claims in the goods or documents. Or a representative may have authority to affect the legal relations of a principal (so-called “apparent authority”) when the principal’s conduct induces the third party in good faith to believe that the representative has such authority. In the composite expression “good faith and fair dealing” the element of good faith encompasses more easily the requirement not to act out of pure malice. A person should, for instance, not be entitled to exercise a remedy if doing so is of no benefit and if the only purpose is to harm the other party. The fair dealing element refers more easily to fairness in fact, regardless of motivation. The essence of the composite concept is a requirement to show due regard for the interests of the other party. What is due regard will depend on the circumstances, including the nature of the contract. In many commercial contracts the rights and obligations of the parties will be so carefully regulated that in the normal course of events considerations of good faith and fair dealing will remain entirely in the background.

C. The role of the duty

The role of the duty of good faith and fair dealing under this Article must be distinguished from the wider roles the concept of good faith and fair dealing may play under other Articles. We have already seen that good faith and fair dealing may play an important role in the interpretation and development of these rules as a whole and in the filling of gaps in their provisions. The concept is also relevant to the interpretation of contracts and other juridical acts and to the ascertainment of tacitly agreed terms and the creation of implied terms to fill a gap in a contract’s provisions. In these wider contexts the instruction to have regard to good faith and fair dealing is directed to the judge or interpreter. In the present context, as also in the earlier Article imposing a duty to negotiate in accordance with good faith and fair dealing, the instruction is directed to the parties.

The role of the duty under this Article must also be distinguished from the historical role the duty has played already in determining the existence and content of many specific rules of law. Particular applications of the requirements of good faith and fair dealing appear in many specific provisions, such as the duty of a party not to negotiate a contract with no real intention of reaching an agreement with the other party, not to disclose confidential information given by the other party in the course of negotiations, and not to exploit unfairly the other party’s dependence, economic distress or other weakness. Good faith and fair dealing could also be said to underpin the debtor’s rights to cure a defective

performance; the debtor's right to refuse to make specific performance of a contractual obligation if this would involve unreasonable effort and expense; and the requirement that a creditor should limit as far as possible any loss which will be suffered as a result of a non-performance of the obligation by the debtor, thereby reducing the amount of damages.

The role of the duty under the present Article is to serve as a direct and general guide for the parties. Its purpose is to give effect in legal transactions to community standards of decency and fairness. The law expects the parties to act in accordance with the requirements of good faith and fair dealing. The consequences of a breach of the duty are discussed later. They may be serious.

D. Rule is intended to be mandatory

Paragraph (2) provides that the duty may not be excluded or limited by contract. Of course, as noted above, these rules cannot make anything mandatory. This provision serves only as an indication that any legislator adopting the principle might be expected to consider making it mandatory.

What is in accordance with good faith and fair dealing will, however, to some extent depend upon what was agreed upon by the parties in their contract. Thus, parties may agree that even a technical breach by one party will entitle the other party to refuse performance, when, for instance, that party's representatives can ascertain a technical breach but not whether it is a trifle or not.

E. Effect of breach

Paragraph (3) provides that breach of the duty does not give rise directly to the remedies for non-performance of an obligation but may preclude the person in breach from exercising or relying on a right, remedy or defence which that person would otherwise have. The word "precluded" is not intended to mean that the person must be entirely precluded: a partial preclusion or restriction may be sufficient in some cases.

The word "directly" is significant. If good faith and fair dealing have resulted in a tacit or implied term of a contract or other juridical act then, of course, that term will take effect like any other term. If it imposes an obligation then non-performance of that obligation will give rise to all the available remedies in the usual way. There is a policy decision here. It would have been possible to provide for an obligation (rather than a mere duty) to act in accordance with good faith and fair dealing and to attach the normal consequences to a non-performance of that obligation, including the possibility of an order for specific performance or an award of damages. Using the filter of an implied term, however, perhaps gives slightly more weight to the autonomy of the parties and leaves slightly less room for a court to hold a party liable in damages where the party has complied with the agreed terms of the contract. It makes it clear that the function of a court is to use the duty of good faith and fair dealing to fill gaps where necessary but not to use the duty to correct or improve the contract by making it more fair than the parties themselves intended. Moreover, the normal remedies for non-performance of an obligation do not

always seem appropriate for a breach of the duty to act in accordance with good faith and fair dealing. The idea of a court order compelling a party, subject to sanctions which might be severe, to act fairly could be said to confuse the roles of law and morality. Moreover the remedy of withholding performance of a reciprocal obligation does not seem attractive in this area. One party should not be able to say “I am not going to perform my obligation to act fairly until you perform your obligation to act fairly.”

Other Articles in these rules provide for damages for loss caused by fraud, unfair exploitation or misuse of confidential information. In most if not all of such cases there will also have been a breach of the duty of good faith and fair dealing. There is also an overlap between the duty of good faith and fair dealing and the obligation on parties to co-operate so as to enable an obligation to be performed. Breach of that obligation may also give rise to a liability to pay damages.

One consequence of a breach of the duty of good faith and fair dealing is that it may preclude the person in breach from taking advantage of a term in a contract or of a rule in a way which, given the circumstances, would be unacceptable according to the standards of good faith and fair dealing. Contract language which gives a party such a right should not be enforced. Thus, even if a contract provides that a certain type of non-performance of an obligation is to be regarded as fundamental, a creditor would not necessarily be permitted to terminate the contract because of a completely trivial and irrelevant failure to perform in the required way.

The principle of good faith and fair dealing also covers situations where a party without any good reason stands on ceremony.

Illustration 1

In an offer to B, A specifies that in order for B’s acceptance to be effective B must send it directly to A’s business headquarters where it must be received within 8 days. An employee of B overlooks this statement and sends the acceptance to A’s local representative who immediately transmits it to A’s headquarters where it is received 4 days later. It would be contrary to good faith and fair dealing for A to rely on the technicality to deny a contract.

The principle covers a party’s dishonest behaviour.

Illustration 2

The contract between A and B provides that A must take legal proceedings against B within two years from the final performance by B if A wants to make B liable for defects in B’s performance. Some time before the expiration of this time limit A discovers a serious defect in B’s performance and notifies B of an intention to claim damages. B uses dilatory tactics to put A off. On several occasions B assures A that A has no reason for concern. B undertakes to look into the matter, but insists that the investigation will have to be done carefully. When, after the expiration of the time limit, A loses patience and sues B, B invokes the

time limit. Not having acted in good faith, B is precluded from relying on the time limit.

In relationships which last over a long period of time, such as many tenancies, agencies, distributorships, partnerships and employment and insurance relationships, the concept of good faith and fair dealing has particular significance as a guideline for the parties' behaviour. It underlies many of the specific rules in, for example, the Part of Book IV dealing with Commercial Agency, Franchise and Distributorship, including the rules on continuation or termination of the contractual relationship (see IV.E.–2:301 (Contract for a definite period) and IV.E.–2:302 (Contract for an indefinite period)) but has an important role to play even in areas not specifically regulated.

F. Inconsistent behaviour

A particular application of the principle of good faith and fair dealing is to prevent a party, on whose statement or conduct the other party has reasonably acted in reliance, from adopting an inconsistent position. This translates directly into a number of provisions in these rules, e.g. the rule that a revocation of an offer is ineffective 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; the rules under which a party by statement or conduct may be precluded from asserting a merger clause or a no-oral-modification clause to the extent that the other party has reasonably relied on the statement or conduct; the rule that an apparent authority of a representative which has been established by a principal's statements or conduct will bind the principal to the acts of the representative; and the rule that if a common intention of the parties as to the interpretation of a contract cannot be established, the contract is to be understood according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

The rule is, however, broader than any of these specific provisions. It is a general principle that a person who has induced another person to incur a change of position on the faith of an act should not be allowed to set up the invalidity of an act or another reason for its not being binding.

Illustration 3

An importing firm asked its bank to collect on a negotiable instrument. The bank mistakenly reported to the customer that the money had been paid and paid the customer its value. When it was discovered that the amount had not been paid, the importer had irrevocably credited the amount to its foreign business partner. The bank is precluded from reclaiming the payment.

III.–1:104: Co-operation

The debtor and creditor are obliged to co-operate with each other when and to the extent that this can reasonably be expected for the performance of the debtor's obligation.

COMMENTS

A. Terminology

The Article refers to an “obligation” to co-operate rather than a “duty” to co-operate because in this case the policy is that the normal remedies for non-performance of an obligation are to be attracted. See Comment G. The Principles of European Contract Law achieved this result indirectly by first providing that there was a duty to co-operate (Article 1:202) and then providing that non-performance of a contractual obligation included failure to co-operate in order to give full effect to a contract. (Article 1:301). This should not be seen, however, as a deliberate choice of an unnecessarily complicated approach. The truth is that the Principles did not distinguish clearly between duties and obligations.

B. The obligation to co-operate

Where a debtor owes an obligation, the debtor and creditor each have a subsidiary obligation to co-operate with the other when this can reasonably be expected for the performance of the debtor’s obligation. This can be regarded as a particular application of the duty of good faith and fair dealing.

The obligation to co-operate includes an obligation to allow the debtor to perform and thereby earn any fruits of the performance.

Illustration 1

S in Hamburg agrees to sell goods to B in London at a stated price f.o.b. Hamburg. B fails to nominate a vessel to carry the goods. Such failure constitutes non-performance of B's obligations under the sales contract and also infringes this Article by preventing S from performing S’s own obligation to ship the goods and thereby earn the contract price. S can terminate the contractual relationship and recover damages.

Illustration 2

B contracts to erect an office building for O. As the result of O's failure to apply for a building licence, which it is clearly O’s responsibility to obtain, and which would have been granted, B is unable to proceed with the building works. O thereby infringes the requirements of this Article, whether or not the contract with B imposed on O an express obligation to apply for the licence. O has no remedy against B for failing to build and is liable to B for non-performance of the obligation to co-operate.

A party to a contract has to inform the other party if the other party in performing the contract may not know that there is a risk of harm to persons or property.

Illustration 3

Subcontractor S of country A is about to send some staff to perform S's contractual obligation to Contractor C, also from country A, to assist in building a dam in country Y. C learns that the government of Y intends to detain any citizens from A who are found in Y as hostages, in order to exert pressure on the government of A to release some of Y's citizens who have been detained in A charged with terrorism. C has an obligation to inform S of the risks involved in sending staff to Y.

The obligation to co-operate may be particularly important in relation to the obtaining of licences or permissions on which the performance of a primary obligation depends. Often there will be an express or tacit term on such matters but in the absence of such a term the obligation to co-operate will come into play.

C. Obstruction of performance

Non-performance of the obligation to co-operate may take the form of obstruction of performance of the main obligation. Obstruction of performance may result either from non-performance of a specific obligation imposed on a party by a contract or by the law (such as the obligation of the buyer of goods to accept delivery) or from some other act which has the effect of preventing or inhibiting performance by the other party. For example a party's refusal to accept performance constitutes a breach of the obligation to co-operate where the other party has an interest in having performance accepted.

Illustration 4

S contracts to do something which requires access to B's land. S has an obvious interest in performing the contractual obligation. B, however, refuses to accept performance and denies S access. This constitutes non-performance by B of the obligation to co-operate.

D. Right to withhold performance

A party may in certain circumstances withhold performance of the party's own obligations until the other party has performed. This will include the right to withhold performance of the obligation to co-operate.

E. Co-operation required only so far as this can reasonably be expected

An absolute obligation of co-operation in order to enable the main obligation to be performed would go too far and might, for example, interfere with a contractual allocation of obligations. This is why the obligation is to co-operate only when and to the extent that this can reasonably be expected for the performance of the debtor's obligation. There are, for example, cases where co-operation cannot reasonably be expected until the other party has first taken some step.

Illustration 5

The facts are as in Illustration 1 except that S is given the right to ship the goods at any time during July or August. B is under no obligation to nominate a vessel until B has received notification from S of the time at which S intends to ship the goods.

F. Effects of failure to perform obligation to co-operate

Failure to perform the obligation to co-operate has the same effects as failure to perform any other contractual obligation and attracts the various remedies prescribed for non-performance of a contractual obligation. These remedies include specific performance. So, for example, if X needs access to Y's land in order to perform the obligations under a contract between them and if Y refuses access for no good reason, X could obtain a court order compelling Y to grant access. It should be noted, however, that there are general restrictions on the remedy of specific performance which could be particularly relevant in relation to the obligation to co-operate. For example, a person could not be forced to accept services or work of a personal character.

III.-1:105: Non-discrimination

Chapter 2 (Non-discrimination) of Book II applies with appropriate adaptations to:

- (a) the performance of any obligation to provide access to, or supply, goods, services or other benefits which are available to members of the public;*
- (b) the exercise of a right to performance of any such obligation or the pursuing or defending of any remedy for non-performance of any such obligation; and*
- (c) the exercise of a right to terminate any such obligation.*

COMMENTS

This Article is needed because the provisions in Chapter 2 (Non-discrimination) of Book II apply only to contracts and juridical acts and not to the obligations and corresponding rights arising out of them. It is clear, however, that the principle of non-discrimination in that Chapter is as important in relation to the performance of the relevant obligations and the exercise of corresponding rights to performance as it is in relation to such matters as the initial decision to conclude or not to conclude a contract. The same goes for the decision to terminate any such obligation.

On the content of the Article see the Comments to the Articles in Book II. Chapter 2 (Non-discrimination).

III.-1:106: Conditional rights and obligations

(1) The terms regulating a right or obligation may provide that it is conditional upon the occurrence of an uncertain future event, so that it takes effect only if the event occurs (suspensive condition) or comes to an end if the event occurs (resolutive condition).

(2) Upon fulfilment of a suspensive condition, the relevant right or obligation takes effect.

(3) Upon fulfilment of a resolutive condition, the relevant right or obligation comes to an end.

(4) When a party, contrary to the duty of good faith and fair dealing or the obligation to co-operate, interferes with a condition so as to bring about its fulfilment or non-fulfilment to that party's advantage, the other party may treat the condition as not having been fulfilled or as having been fulfilled as the case may be.

(5) When a contractual obligation comes to an end on the fulfilment of a resolutive condition any restitutionary effects are regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) with appropriate adaptations.

COMMENTS

A. Need for provision

Most of this Article is not necessary for substantive purposes. It already follows from the principle of party autonomy that contracting parties can make a right or obligation, or the whole complex of rights and obligations involved in their contractual relationship, or indeed any other result, conditional on the occurrence or non-occurrence of an uncertain future event. And it goes without saying that a legislator could do the same. In the absence of provision to the contrary, a term providing that a right or obligation would come into effect, or would cease to have effect, on the occurrence of an event would not have retrospective effect. So substantively the first three paragraphs of the Article do nothing. They are, however, useful for the purposes of establishing a recognised terminology on suspensive and resolutive conditions. Paragraph (4) does have a substantive effect. It is considered below.

B. Meaning of “conditional”

A right or obligation is conditional if it is subject to an “if” provision. Either it becomes effective “if” something happens or it ceases to be effective “if” something happens. The “something” must be an uncertain future event.

Illustration 1

The Government of Bettaravia has suspended indefinitely all exports of sugar beets from its ports. A contract requires the seller to ship beets on 31 July if the export embargo has been lifted by that date. This is a suspensive condition affecting the seller's obligation.

Illustration 2

Under a joint venture agreement, a landscape gardener and a water engineer agree to develop land for a theme park if an environmental permit becomes available. This is a suspensive condition affecting both parties' obligations.

An obligation may be conditional on the occurrence of a future uncertain event even although the condition is expressed negatively and refers to the non-occurrence of the event.

Illustration 3

A contract for the sale of sugar beets f.o.b. a named port in the country of Bettaravia provides that the seller's obligation to deliver is dependent upon the Government of Bettaravia not introducing export restrictions on sugar beets before the date fixed for delivery. Here the uncertain event is the introduction of the restrictions. The seller's obligation to deliver on the due date is subject to a resolutive condition. It will come to an end if the Government introduces export restrictions before that date.

C. An uncertain event

The essence of a condition, within the meaning of the Article, is its uncertain character. This uncertainty stems from external events which the parties to the contractual or other legal relationship may in certain cases be able to influence but which they do not control. The reference to an "uncertain future event" is not intended to cover the performance or non-performance by the debtor of the debtor's own obligations under the contract. The consequences of the "bringing about" by a debtor of the performance or non-performance of the debtor's obligations are regulated by the terms regulating the obligations and the rules on the remedies for non-performance and not by paragraph (4) of the present Article. By exercising due diligence, a party may help to bring about the fulfilment of a suspensive condition or prevent the occurrence of a resolutive condition. For example, in a contract for the export of goods the seller's obligation may be conditional on the award of an export licence. This may be subject to a quota or other system of discretionary control operated by the authorities. The award of an export licence may therefore be affected by the diligence and skill with which the applicant makes a case to the authorities. The seller's obligation to deliver the goods is nevertheless conditional upon the award of the licence.

Some conditions, however, will be so heavily dependent upon the will of one party as to signify a total lack of contractual commitment by that party and hence the absence of a binding contract. For example, a company may say that it will do something or pay a sum of money if, as a matter of pure discretion, it chooses to do so. This is not a conditional obligation: it is not an obligation at all. Such arbitrary conditions are to be distinguished from valid conditions where one party's obligation is dependent upon the will of another. A seller, for example, may be bound to supply raw materials to a buyer at a stated price in the event of the buyer deciding to accept an offer by a third person to purchase goods specially manufactured by the buyer.

D. A future event

An obligation may *appear* to be conditional upon a past event in those cases where the parties do not know whether the event has occurred. Uncertainty concerning past events may play a vital role in shaping rights and obligations, even in a world of rapid

communication. Nevertheless, on a true interpretation of the situation, it is often not the past event that forms the basis of the condition but the future publication or availability of information concerning that event.

Illustration 4

A agrees to purchase from B a number of shares in company C if C's net profits in the preceding financial year reached a stated minimum figure. It is not known at the time of the agreement whether the profits did reach the figure. The past profits of C will become known only when its accounts have been finalised. A's obligation falls to be interpreted as conditional on an uncertain future event – whether or not the amount of net profits brought out in the final accounts reaches the stated figure.

E. Operation of law

A right or obligation may be conditional on compliance with a country's law which is not the law applicable to the obligation.

Illustration 5

A contract for the export of works of art from Pictoria provides that the seller's obligation is conditional upon the export being lawful according to Pictorian law, which is not the law governing the contract. Pictorian law requires an export licence. The seller's obligation is therefore conditional upon the grant of a licence by the Pictorian authorities.

In the above illustration, the seller may be under a separate contractual obligation, express or implied, to obtain the licence or to use due diligence to obtain the licence and may be in breach of *that obligation*, as opposed to the delivery obligation, if unsuccessful in obtaining the licence.

F. Suspensive and resolute conditions

In the case of a suspensive condition, the creditor may not demand performance from the debtor whose obligation is suspended for that would be to alter the basis of the bargain. This does not prevent a debtor from incurring liability for anticipated non-performance in accordance with the rules on that subject.

As is the case with suspensive conditions (see Illustrations 1 and 2 above), a resolute condition may qualify the obligations of one party or both parties.

Illustration 6

A contract for the sale of five separate weekly shipments of 10,000 Russian Birchwood standards to be shipped from a northern Russian port provides for the parties' future obligations under the contract to come to an end if, contrary to expectations, the port is closed by ice before all the shipments have been made. The port is closed by ice after four shipments have been made. The parties' obligations were subject to a resolute condition. In relation to the last shipment

the condition has been fulfilled. The seller is no longer liable to make the last shipment and the buyer is no longer bound to pay for it.

G. Effect of fulfilment of conditions

The rule expressed in paragraphs (2) and (3) of the Article ascribes a prospective (or *ex nunc*) effect to the fulfilment of a condition unless otherwise provided. This is the simplest default rule. A rule giving retrospective effect to the fulfilment of a condition would have had to be subject to significant exceptions.

An example of prospective effect in the case of a suspensive condition is the following.

Illustration 7

A contract for the sale of a house in Bordeaux provides that the seller's obligation to sell is subject to the seller being appointed to a senior civil service position in Paris by a stated date. The seller is duly appointed.

It is only when that appointment is made that the seller's obligation to sell the house takes effect as an unconditional obligation. Before that there is only a conditional obligation.

An example of prospective effect in the case of a resolutive condition is the following.

Illustration 8

A carrier enters into a contract with a farmer to transport water by lorry to the farm for four weeks but this obligation is to come to an end if the local drought comes to an end within that time. Under the contract, the farmer pays carriage charges 30 days after each delivery.

The end of the drought within the four week period brings to an end the carrier's obligation. The farmer, nevertheless, remains bound to pay outstanding charges for deliveries made before the end of the drought. These charges are not affected by the condition: they accrue with each delivery even if payable in the future.

Problems regarding the recovery of money or property paid or delivered in the expectation that a condition will be fulfilled or not fulfilled may be resolved by the terms regulating the relevant obligations. For example, it may be expressly provided that a deposit is to be forfeited or returned. If the matter is not regulated it will be resolved by the rules in Chapter 8 which deal with such matters generally in relation to obligations which are extinguished otherwise than by performance.

H. Interference with conditions

Paragraph (4) deals with the situation where the debtor or creditor interferes with a condition, either by preventing it from being fulfilled or by bringing about fulfilment, in breach of the duty of good faith and fair dealing or the obligation to co-operate. It gives

the other party an option to treat the condition as fulfilled or not fulfilled as the case may be.

Illustration 9

The licensing of a software package by D to E is agreed by the parties to be dependent upon the professional approval of the package by an independent computer engineer, F, who is nominated by D. The contract is favourable to D and unfavourable to E. Despite F's professional misgivings, D persuades F to approve the package. D, having acted contrary to good faith and fair dealing, cannot rely on F's approval, so that E is under no obligation to perform the licensing agreement and may have a right to damages for any loss caused by D's breach of the obligation to co-operate.

The above example is an illustration of interference with a suspensive condition. Similar results may follow if there is interference with a resolutive condition.

Illustration 10

S enters into a contract to sell a horse to B. B expects to sell the horse on to T. S and B agree that B's obligation under the contract is to come to an end if T does not take the horse by a certain date. B also obtains another horse from a different seller and sells this horse to T instead, making no effort to sell T the horse purchased from S.

If the innocent party chooses not to exercise the option conferred by this paragraph the normal consequences of a breach of the duty to act in accordance with good faith and fair dealing or a non-performance of the obligation to co-operate will follow. This means that the interfering party may not be able to rely on any right which would have accrued as a result of the wrongful interference and may be liable in damages for non-performance of the obligation to co-operate. In many cases the innocent party will also be able to terminate the contractual relationship for fundamental non-performance.

It should be noted that the result of an interference with a condition is not necessarily that it is deemed to be fulfilled for all purposes. That could produce rigid and unacceptable results. For example, it could preclude the innocent party from terminating the contractual relationship or obtaining damages.

Illustration 11

The licensing of a software package by B to A is agreed by the parties to be dependent upon the professional approval of the package by an independent computer engineer, C, who is nominated by A. Regretting the bargain, A bribes C, against C's better judgement, to disapprove the software package.

If the condition were deemed to be fulfilled then both A and B would be bound to proceed with the contract. However, given A's cynical and serious breach of the duty to act in accordance with good faith and fair dealing and A's non-performance of the

obligation to co-operate, B may prefer to terminate the contractual relationship and claim damages for any loss caused by A's conduct. There can also be cases where deeming a condition to be fulfilled makes no practical sense. For example, there is no point in deeming a condition relating to the obtaining of an export licence to have been fulfilled if the licence has not in fact been obtained. Damages are a much better remedy.

I. Restitutionary effects

It may happen that when a contractual obligation comes to an end because of the fulfilment of a resolutive condition there has been part performance of an obligation, or performance of a reciprocal obligation. The question whether either party is bound to return or pay the value of whatever has been received from the other in such circumstances is regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) .

Illustration 12

X has paid in advance for something which is to be supplied by Y. Y's obligation comes to an end because of the fulfilment of a resolutive condition. The rules in Chapter 3, Section 5, Sub-section 4 (Restitution) mean that Y has to return the payment.

If a person has paid or transferred something in the anticipation that a suspensive condition will be fulfilled and the condition is not fulfilled, the situation is different. The payment or transfer would have taken place in the absence of any legal obligation and with no intention of donation. In such circumstances the law on unjustified enrichment would come into operation and the payment or property transferred would normally be recoverable on that basis.

III.-1:107: Time-limited rights and obligations

(1) The terms regulating a right or obligation may provide that it is to take effect from or end at a specified time, after a specified period of time or on the occurrence of an event which is certain to occur.

(2) It will take effect or come to an end at the time or on the event without further steps having to be taken .

(3) When a contractual obligation comes to an end under this Article any restitutionary effects are regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) with appropriate adaptations.

COMMENTS

A. Time clauses and conditions

Terms relating to time must be distinguished from conditions. A debtor may be obliged to perform on a future date which is fixed and sure to arrive, as would be the case where a

contract of sale is concluded on July 1 with delivery to be made by the seller on July 15. It would be a misuse of language to say that the obligation to deliver is conditional upon the arrival of the due date, for July 15 is sure to arrive. The obligation does not depend on the occurrence of a future uncertain event. It is an existing, unconditional obligation to perform in the future. The right which corresponds to it is an existing, unconditional right to future performance.

Similarly an obligation which is to come to an end on a specified time or after a specified period of time is not subject to a resolutive condition, although the effect is rather similar.

The line between conditional and temporal terms is not always clear-cut. Some events must occur though the date of their occurrence cannot be known. Provisions referring to such events will often be temporal terms as is recognised in the Article, but may involve a hidden condition if the obligation is contingent on something else happening or not happening before the specified event.

Illustration 1

X is bound to pay Y €5000 when Z dies. This is not a condition but a simple time term. Z is bound to die. The term is a “when” term, not an “if” term.

Illustration 2

The trustees of a family settlement undertake to provide A with alimentary support on the death of B, her father. Since B’s death is sure to happen, this may look at first sight like an obligation which is future but not conditional. However, A may die before B, in which event the trustees would be under no obligation. So in fact the obligation is conditional on A surviving B.

B. Restitutory effects of extinction of contractual obligation by expiry of time

In many cases the parties to a contract will know in advance when an obligation is going to come to an end by the expiry of a specified time and will ensure that it is fully performed and that any reciprocal obligation is also fully performed. It may happen, however, that an obligation comes to an end unexpectedly by the arrival of a time limit - for example, one expressed by reference to an event which is certain to arrive but not at a time which can be known in advance. In such cases the situation is effectively the same as when a resolutive condition is fulfilled. At the moment when the obligation comes to an end something may have been transferred from one party to the other in part performance or attempted performance. Or one party may have performed in expectation of a reciprocal performance which is no longer forthcoming because of the unexpected extinction of the relevant obligation. The rules in Chapter 3, Section 5, Sub-section 4 (Restitution) regulate such questions. Normally there would be an obligation on the part of the recipient to return what had been received.

Illustration 3

X has paid in advance for something which is to be supplied by Y. Y's obligation comes to an end because of the unexpected arrival of a time limit. The rules in Chapter 3, Section 5, Sub-section 4 (Restitution) mean that Y has to return the payment.

III.-1:108: Variation or termination by agreement

(1) A right, obligation or contractual relationship may be varied or terminated by agreement at any time.

(2) Where the parties do not regulate the effects of termination, then:

(a) it has prospective effect only and does not affect any right to damages, or a stipulated payment, for non-performance of any obligation performance of which was due before termination;

(b) it does not affect any provision for the settlement of disputes or any other provision which is to operate even after termination; and

(c) in the case of a contractual obligation or relationship any restitutionary effects are regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) with appropriate adaptations.

COMMENTS

The debtor and creditor can always agree to vary or terminate the obligation and corresponding right; the parties to a contract can always agree to vary or terminate their relationship. The agreement need not be express. It may be implied from what the parties have said or done. For example, the extinction of a contractual obligation may sometimes be inferred from the fact that a new contract has been concluded on, or in relation to, the same subject-matter. This is sometimes known as novation but that term is used in different senses in different legal systems. The extinction of a right or obligation should not, however, be readily implied. Only if that is clearly the intention of the parties should that result follow.

The parties will normally regulate the effects of a termination by agreement. Paragraphs (2) and (3) of the Article merely provide default rules. In the absence of agreement to the contrary, termination is prospective in effect. It does not affect liability for damages caused by past non-performance. It does not affect provisions of a contract, such as an arbitration clause, intended to survive termination.

When an obligation is terminated by agreement the parties will normally regulate what is to happen to anything already transferred from one to the other in part performance or attempted performance of the obligation or under a reciprocal obligation. In any case where, unusually, they forget to do so, the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) would come into play. Those rules would normally require the recipient party to return what had been received.

Illustration

X has paid in advance for something which is to be supplied by Y. Circumstances change and the parties agree to terminate Y's obligation. X assumes that the advance payment will be returnable but forgets to mention this. So nothing is said about it in the agreement. The rules in Chapter 3, Section 5, Sub-section 4 (Restitution) mean that Y has to return the payment. Of course, if the parties want Y to keep the advance payment they can easily provide for this, but the default rule is that it is returnable.

Not all the laws accept that a mere agreement to vary or terminate an obligation will be effective. Those which require an additional element for the formation of a contract (such as consideration) may require it also for an agreement to vary or terminate an obligation, though in modern laws the requirements appear sometimes to have been attenuated. The present rules do not require any such additional element for either the formation of a contract (see II.-4:101 (Requirements for the conclusion of a contract)) or its variation or termination.

III.-1:109: Variation or termination by notice

(1) A right, obligation or contractual relationship may be varied or terminated by notice by either party where this is provided for by the terms regulating it.

(2) Where, in a case involving continuous or periodic performance of a contractual obligation, the terms of the contract do not say when the contractual relationship is to end or say that it will never end, it may be terminated by either party by giving a reasonable period of notice. If the performance or counter-performance is to be made at regular intervals the reasonable period of notice is not less than the interval between performances or, if longer, between counter-performances.

(3) Where the parties do not regulate the effects of termination, then:

(a) it has prospective effect only and does not affect any right to damages, or a stipulated payment, for non-performance of any obligation performance of which was due before termination;

(b) it does not affect any provision for the settlement of disputes or any other provision which is to operate even after termination; and

(c) in the case of a contractual obligation or relationship any restitutionary effects are regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) with appropriate adaptations.

COMMENTS

A. General

This Article provides for two situations in which a right, obligation or contractual relationship may be terminated by unilateral notice. The first is where this possibility is

provided for by the terms regulating the obligation. The second is where the contract is for an indefinite or perpetual duration.

B. Variation or termination by notice as provided for by terms regulating right or obligation

The principle of party autonomy means that it is possible for the parties to agree on rights to terminate for any reason or none. The effects of exercising such an agreed right to terminate in a case not involving fundamental non-performance will depend primarily on the terms of the provision conferring it. In the absence of clear provision to the contrary, accrued rights to damages would not be affected but neither party would be entitled to damages for the fact that any performance falling due in the future would not any longer have to be made.

Illustration 1

A long-term supply contract under which a certain quantity of goods has to be delivered every month for ten years provides that the purchaser can terminate the relationship on giving one month's notice if the purchaser no longer needs the supply to be continued. In due course the purchaser exercises this right in good faith. The purchaser is not liable to pay damages for terminating the contractual relationship. The seller is not liable to pay damages for not performing in the future.

Illustration 2

A long-term supply contract under which a certain quantity of goods has to be delivered every month for ten years provides that the purchaser can terminate the whole contractual relationship on giving one month's notice and without giving any opportunity to cure if there is even a minor non-conformity in any delivery. After some years of satisfactory performance there is, because of the negligence of a temporary employee of the seller, a minor non-conformity in one delivery. There is no reason to suppose that there will not be satisfactory performance in the future. The purchaser exercises the right to terminate, returns the goods to the seller and buys elsewhere. The purchaser is not liable to pay damages for terminating the contractual relationship. The seller is liable to pay damages for loss caused by the non-conforming delivery but is not liable to pay damages for not performing in the future. The contractual relationship has been terminated. Neither party has any further obligations to perform under it.

In some cases the parties may wish to provide not only for an agreed right to terminate but also for the payment of compensation or extended damages (going beyond what would be payable under the normal rules) by one or the other. For example the purchaser under a long-term supply contract may be given the right to terminate by notice but only on compensating the supplier for extra costs incurred in gearing up to meet the purchaser's special requirements. Or the purchaser may be given the right to terminate for a minor breach and also the right to damages for the extra costs of obtaining supplies elsewhere for the whole remaining period of the contract. Whether the parties have provided not only for a right to terminate but also for compensation or damages beyond

what would be due under the normal rules will depend on the terms of the contract, interpreted in accordance with the rules on interpretation.

C. Contracts of indefinite or perpetual duration

Paragraph (2) applies both to contractual relationships which purport to be everlasting and to such relationships which are for a period the duration of which cannot be determined from the contract. It expresses two principles:

- (1) even a contractual relationship which purports to be everlasting may be ended: no party is bound to another for an indefinite period of time.
- (2) to end such a relationship, or one which is for an indeterminate period, either party must give reasonable notice.

The paragraph applies only where the case involves continuous or periodic performance under a contract and only where the time when the contractual relationship is to end cannot be determined from the terms of the contract. Accordingly it will not apply if the contract provides for a fixed duration or a fixed time of termination. Also, it will not apply if the contractual relationship is to last for a “reasonable time” because that expression can be interpreted and applied to the circumstances: a time for the relationship to end can be determined from the terms of the contract. Similarly, a contract for life will not be within the scope of the paragraph. Whether such a contract is valid will depend on other provisions of these rules. If it is in effect a contract of quasi-servitude then it could be void on the ground that it infringes the fundamental right to liberty. Again, a contractual relationship which is to last until a particular job is completed, or until the occurrence of an uncertain event, would not be within the paragraph. It is, in one sense, for an indefinite duration but a time for it to end is determinable from the contract.

In practice certain types of contract often give rise to relationships which are to last for indefinite periods. This is often the case under agency and distributorship contracts, under franchising contracts, partnerships and joint ventures, for contracts for the supply of services, goods and electricity and for leasing. Such contracts often do not contain any provision for the termination of the relationships to which they give rise.

The principle does not cover cases where the contract provides a method of termination – for example, a period of six months notice. In such cases the contract says when the contractual relationship will end.

The principle may, however, apply to contractual relationships which were originally for a definite period, but which the parties have tacitly continued after the end of that period although they have not expressly agreed to renew them.

The scope of the paragraph may be regarded as rather arbitrary from the policy point of view. Why, it may be asked, does it not apply to a contractual relationship which is to last for 200 years, or until the occurrence of an event which in practice is very unlikely to

occur? The answer is that the autonomy of the parties is to be respected. The results are not so dramatic as might at first sight be supposed because in the case of contracts for such very long periods the rules on change of circumstances and termination for serious grounds (see next paragraph) would often provide a means of escape.

The party intending to end the contractual relationship under paragraph (2) must give a reasonable period of notice. What is reasonable depends, among other things, upon the period the contractual relationship has lasted, the efforts and investments which the other party has made in performance of the contract, and the time it may take the other party to obtain another contract with somebody else. The length of notice will often be governed by usages. The second sentence of paragraph (2) provides added specification as to what will be regarded as a reasonable period of notice in cases where performance or counter-performance is due at regular intervals. Essentially the interval between performances (or counter-performances, if longer) is regarded as a reasonable period of notice.

D. Time when notice takes effect

Following the general rules on notices, the notice which purports to end the contractual relationship will not be effective unless and until it reaches the person to whom it is sent.

E. Restitutionary and other effects

The question whether either party is bound to return or pay the value of whatever has been received from the other when an obligation is extinguished as a result of a notice given under this Article is regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution).

Illustration 3

A contractual relationship of indefinite duration is terminated by notice under paragraph (2). At the time of termination one party has supplied part of a consignment of goods. Payment for the whole consignment is due 28 days after the whole consignment has been delivered. Termination extinguishes both parties' obligations for the future. The effect of the rules in Articles Chapter 3, Section 5, Sub-section 4 (Restitution) is that the supplier is entitled to the return of what has been supplied in part performance of the extinguished obligation.

The other effects are the same as for the preceding Article. In other words, termination has prospective effect only but does not affect provisions intended to survive termination.

Of course, the terms regulating the obligation may provide for more extensive effects than would normally follow. A contract for example may give one party a right to terminate the whole contractual relationship for even a minor and non-fundamental non-performance by the other and may provide for a stipulated sum or extended damages to be paid not only for loss caused by that non-performance but also for the fact that the terminating party will lose the benefit of future performance of the extinguished obligations. There are some limited controls on unfair contract terms, acting contrary to the requirements of good faith and fair dealing and excessive stipulated payments in lieu

of damages but, if these usual controls do not come into play, such contractual provisions have to be respected and applied. It may be expected, however, that a party who wishes to have extended or unusual rights to payment from the other party after termination should provide for such rights in clear terms.

III.-1:110: Variation or termination by court on a change of circumstances

(1) An obligation must be performed even if performance has become more onerous, whether because the cost of performance has increased or because the value of what is to be received in return has diminished.

(2) If, however, performance of a contractual obligation or of an obligation arising from a unilateral juridical act becomes so onerous because of an exceptional change of circumstances that it would be manifestly unjust to hold the debtor to the obligation a court may:

(a) vary the obligation in order to make it reasonable and equitable in the new circumstances; or

(b) terminate the obligation at a date and on terms to be determined by the court.

(3) Paragraph (2) applies only if:

(a) the change of circumstances occurred after the time when the obligation was incurred,

(b) the debtor did not at that time take into account, and could not reasonably be expected to have taken into account, the possibility or scale of that change of circumstances;

(c) the debtor did not assume, and cannot reasonably be regarded as having assumed, the risk of that change of circumstances; and

(d) the debtor has attempted, reasonably and in good faith, to achieve by negotiation a reasonable and equitable adjustment of the terms regulating the obligation.

COMMENTS

A. General

The majority of countries in the European Community have introduced into their law some mechanism intended to correct the situation which may arise in very exceptional cases when performance of a contractual obligation, although not completely impossible, has become so excessively and disproportionately onerous as a result of supervening events which the parties to a contract could not reasonably have foreseen when they made the contract that it would be grossly unjust to hold them to their obligations. In practice contracting parties often adopt the same idea, supplementing the general rules of law with a variety of clauses, such as "hardship" clauses. If they do not do so, the reasonable conclusion may often be that they assumed the risk. However, this will not always be a reasonable conclusion. There may be cases where the parties simply overlooked the need for a hardship clause or the need for a clause to cover the circumstances which in fact arose.

This Article begins by recognising the important principle that obligations must be performed even if performance turns out to be more onerous than anticipated. It then recognises that there may, however, be cases where an exceptional change of circumstances, which could not reasonably have been taken into account, is so extreme that it would be manifestly unjust to hold the debtor to the obligation. It provides a mechanism whereby, if certain rather demanding requirements are satisfied, a court may adapt the obligation to the changed circumstances or even terminate it altogether.

This Article must be read along with the Article on "impossibility". Although in either case an unforeseen event has occurred, impossibility presupposes that the event has caused an insurmountable obstacle to performance, whereas in the situation covered by this Article performance may still be possible, although ruinous, for the debtor. The consequences are different under the two Articles. Impossibility of performance, if it is total, can only lead to the end of the obligation. Exceptional hardship, under this Article, gives the court the choice of revising the terms regulating the obligation or terminating it altogether. Of course there is sometimes a very fine line between a performance which is only possible by totally unreasonable efforts, and a performance which is only very difficult even if it may drive the debtor into bankruptcy. It is up to the court to decide which situation is before it.

This Article must also be read along with the rules allowing an obligation to be brought to an end in other circumstances, for example the rule allowing an obligation of indefinite duration to be terminated by giving notice. Where an obligation can be terminated by the debtor there will be no need to rely on the present Article.

B. Scope of Article

The court's powers arise only in the case of contractual obligations and obligations arising under a unilateral juridical act. It would not be appropriate to allow a court to modify or terminate an obligation which arises by operation of law, even if the obligation is one which is within the intended scope of these rules. In some cases, as in the obligation to reverse an unjustified enrichment, the question of change of circumstances is already addressed by the relevant rules. In others, as in the case of an obligation to pay damages for loss caused to another, relief based on a change of circumstances does not seem appropriate. And, generally, the idea of assumption of risk which is crucial to the rules on change of circumstances is not applicable in the case of obligations which are not voluntarily undertaken. On the other hand, there is no reason to exclude obligations arising under unilateral juridical acts from the scope of the provision. Indeed there may be a stronger case for including such obligations, which are often gratuitously undertaken, than for including many contractual obligations.

Illustration 1

X has promised to pay to put his niece Y through a 5 year university course. The promise is legally binding. At the time of the promise 90% of university fees are met by the government and there is no reason to suppose that this will change. By

the time, some years later, when Y is ready to embark on the course this government support has been withdrawn and X, who is retired and on a fixed income, cannot afford to perform his obligation without selling his house. X asks Y to accept a lower contribution and to take advantage of the state-backed student loan scheme which has replaced the old system but Y insists that X should sell his house and perform his obligation in full. The obligation can be modified or terminated.

C. The role of negotiation

The Principles of European Contract Law (Article 6:111) imposed an obligation on contracting parties to enter into negotiations with a view to adapting the contract or ending it: damages could be awarded for loss caused by a refusal to negotiate or by breaking off negotiations contrary to good faith and fair dealing. Only if negotiations failed did a court have power to modify or terminate. On consultation, this technique was criticised by some stakeholders as being undesirably complicated and heavy. It was pointed out, for example, that a creditor in an obligation might be acting in a fiduciary capacity and might be placed in a difficult situation of conflict of interests if obliged to negotiate away an advantage.

The present Article takes account of these criticisms. It does not impose an obligation to negotiate but makes it a requirement for a remedy under the Article that the debtor should have attempted in good faith to achieve a reasonable and equitable adjustment by negotiation. There is no question of anyone being forced to negotiate or being held liable in damages for failing to negotiate. The Unidroit Principles (Art. 6.2.3) adopt a similar basic approach but use a slightly different drafting technique. They provide that in case of hardship the disadvantaged party is entitled to request renegotiations and that only if there is a failure to reach an agreement within a reasonable time may the party resort to the court. However, as a matter of drafting, there seems to be no need to provide that a party is entitled to request renegotiations. A party to a contract is entitled to request renegotiations at any time.

D. When do court's powers arise

The Article places strict limits on the powers of the court to vary or terminate an obligation because of a change of circumstances. It is essential that it should do so. Consultation on this topic revealed a great concern that any mechanism for adjusting obligations on the basis of hardship might, if not strictly controlled, undermine fundamental principles of the law of contract and the stability of contractual relations.

Change of circumstances must be exceptional. This requirement was implied in the equivalent Article in the Principles of European Contract Law but was not expressly stated. On consultation, the lack of such a statement was criticised by stakeholders. The present Article makes it clear that the court's power arises only if the change of circumstances is exceptional.

Illustration 2

A canning business buys the whole of a producer's future crop of tomatoes at 10 cents per kilo. It could not obtain an adjustment merely because by harvest time the market price had fallen to 5 cents per kilo as a result of an unexpected flood of imported tomatoes. This sort of situation is not exceptional. (There are other ways of reaching the same result under the Article. For example it could be said that the risk was one which the business must be regarded as having assumed. See below.)

Performance must have become unjustly onerous. The change in circumstances must have made performance of the obligation so onerous that it would be manifestly unjust to hold the debtor to the obligation. When this happens in a contractual situation there will be a major imbalance in the parties' respective obligations. The whole basis of the contractual relationship can be regarded as completely overturned by events.

The excessive onerosity may be the direct result of increased cost in performance - for example, the increased cost of transport if the Suez Canal is closed and ships have to be sent round the Cape of Good Hope. Or, as indicated in paragraph (1), it may be the result of the expected counter-performance becoming valueless; for example if a drastic and unforeseeable collapse in an index of prices means that the debtor will be expected to do demanding and extensive work for practically nothing.

Change must have occurred since obligation was incurred. The next requirement is that the change of circumstances must have occurred after the obligation was incurred. In the case of a contractual obligation this will normally be the time when the contract was made. If, unknown to either party, circumstances which make the contract excessively onerous for one of them already existed at that date, the present Article does not apply. In certain cases, but not in all, the rules on mistake may come into operation.

Illustration 3

A building contractor submits an estimate for replacing some stonework in a house. The house owner accepts the estimate. After the old stonework has been removed the contractor asks for an increase in the price on the ground that when he submitted the estimate he did not realise that the price of new stone had recently gone up considerably. The customer is entitled to reply that this is something which the contractor should have checked before submitting the estimate. There has been no change in circumstances since the contract was concluded. The contractor would have no remedy under the present Article.

Circumstances could not have been taken into account. The court's powers will not arise if at the time when the obligation was incurred the debtor took into account, or could reasonably be expected to have taken into account, the possibility or scale of the change of circumstances.

Illustration 4

During a period when the traffic in a particular region is periodically interrupted by lorry drivers' blockades, a reasonable person would not choose a route through that region in the hope that on the day in question the road will be clear; a reasonable driver would choose another route.

Hardship cannot be invoked if the matter would have been foreseen and taken into account by a reasonable person in the same situation as the debtor. A professional can reasonably be expected to take into account matters within the area of professional knowledge or experience, such as the fact that a particular market for a certain raw material is known by those in the trade to be very volatile, even if a consumer could not be expected to be aware of this.

In modern times it is reasonable to expect a considerable degree of fluctuation in the values of currencies and in market prices to be taken into account, particularly over the course of a contractual relationship of long duration, but the same would not necessarily apply to altogether exceptional and sudden fluctuations of a kind which no reasonable person could expect.

Assumption of risk. The court will have no power to vary or terminate the obligation if the debtor assumed the risk of the change of circumstances. Even if there was no actual assumption of risk the court will have no power if the circumstances are such that the debtor can reasonably be regarded as having assumed the risk of the change. It would generally be reasonable to take this view if the obligation arose out of an inherently speculative transaction (for instance a sale on the futures market) or if the events which occurred were within the debtor's own control. Where a professional contracts with a consumer it would also generally be reasonable to regard the professional as having assumed the risk of changes of circumstances in relation to matters within the area of professional expertise.

Debtor must have attempted a negotiated settlement. As noted above, the Article does not impose an obligation on the parties to negotiate. In order to encourage negotiated solutions to the problems caused by changes in circumstances it does, however, make it a requirement for relief that the debtor has attempted, reasonably and in good faith, to achieve a satisfactory negotiated adjustment. The words "reasonably and in good faith" imply that a reasonable time must have been allowed for the negotiation process. It is not expressly stated that the debtor's attempt must have failed but this goes without saying. There would be no point in litigation if a satisfactory adjustment has been negotiated. It will be for the debtor to decide whether an offer by the creditor is so inadequate that the risk of a court application is worth taking.

E. The court's powers

The court is given power to terminate the obligation or modify the terms of the contract or juridical act regulating it. The modification must be aimed at making the obligation

reasonable and equitable in the new circumstances. In the case of a contractual obligation this will normally mean re-establishing the contractual balance by ensuring that any extra costs caused by the unforeseen circumstances are borne fairly by the parties. They should not be placed solely on one of them. The assumption is that, unlike the risks which result from total impossibility, the risks of unforeseen events are to be shared.

A modification could take various forms, including an extension of the period for performance, an increase or reduction in a price, or an increase or reduction in what is to be supplied or provided. Any modification must only be such, however, as will make the obligation reasonable and equitable in the new circumstances. It would not be reasonable and equitable if the effect of the court's order were to introduce a new hardship or injustice.

In some cases the only option open to the court would be to terminate the obligation. The court will have to fix the time as from which termination takes place, taking into account the extent to which performance has already been made. It is this time which will determine the extent of restitution which will become due. The Article also empowers the court to terminate upon terms, for instance by providing that an indemnity is given. It may also order the payment of an addition to the price or of compensation for a limited period and termination at the end of the period.

Although the court has wide powers, the experience of countries which already have a similar rule suggests that these powers are likely to be used in moderation and in such a way as to avoid any reduction in the vital stability of contractual relations.

CHAPTER 2: PERFORMANCE

III.-2:101: Place of performance

(1) If the place of performance of an obligation cannot be otherwise determined from the terms regulating the obligation it is:

- (a) in the case of a monetary obligation, the creditor's place of business;*
- (b) in the case of any other obligation, the debtor's place of business.*

(2) For the purposes of the preceding paragraph:

- (a) if a party has more than one place of business, the place of business is that which has the closest relationship to the obligation; and*
- (b) if a party does not have a place of business, or the obligation does not relate to a business matter, the habitual residence is substituted.*

(3) If, in a case to which paragraph (1) applies, a party causes any increase in the expenses incidental to performance by a change in place of business or habitual residence subsequent to the time when the obligation was incurred, that party must bear the increase.

COMMENTS

A. Significance

The place of performance is significant in several respects. A party who is to perform services will have to bear the inconvenience and the costs of appearing at the place and tendering performance there. For a debtor to tender or offer performance at a wrong place will often constitute a non-performance. In a contract for the delivery of goods the party who is to perform will in general have to bear the costs and carry the risk of the goods until they have been put at the disposal of the creditor at the place of performance. A creditor who makes a mistake about the place of performance and who accordingly is unable to receive performance in due time may also fail to perform obligations or may bear the risk of a non-performance by the debtor.

This makes it very important to have a clear rule as the place of performance when that has not been agreed by the parties, the more so because the laws of the Member States do not reach the same results, particularly when the question is the place of performance of a monetary obligation. The Article adopts the solution found in the majority of the national systems and international conventions.

B. Place otherwise determinable

Very often the place of performance is fixed by, or otherwise determinable from, a contract. A catering company will bring the food and cater for the party at the address given to the company by the host. A contract for the sale of goods may provide for the goods to be delivered to a particular place. In many cases terms derived from usages and practices will determine the place of performance. In many cases the place of performance will be only tacitly agreed and in such cases the knowledge of the parties at the time of concluding the contract may be relevant. For example, if both parties to a contract for the sale of bulky goods know that the goods are in a third country and are required there by the buyer, it may be easy to conclude that there is a tacit agreement that the goods are to be delivered there. Similar situations can arise in relation to contracts for the provision of services.

Illustration 1

Company A which has its headquarters with an accounts department and a shipbuilding yard in Hamburg runs a shipbuilding yard in Bremerhaven as well. By an email to A in Hamburg B, who is a shipowner in London, asks if A can carry out certain repairs to his ship which, known to both parties, is on its way to Bremerhaven. A offers to do the work and quotes a price which A accepts. Nothing is said about the place of performance but because both parties know the ship is going to Bremerhaven it is reasonable to suppose that there was a tacit agreement that the ship is to be repaired there. It would be contrary to good faith for A to remain silent if intending to do the repair in Hamburg.

Similarly, the place of performance may be fixed by, or otherwise determinable from, the terms of a unilateral juridical act, a law, a court order, or a usage or practice imposing or regulating the obligation.

C. Monetary obligations

If the place of performance is not otherwise determinable, the place of performance of a monetary obligation is normally the creditor's place of business. "The debtor must seek the creditor". This rule will leave the debtor with a free choice of how to send or transfer the money to the creditor, who, when the debtor carries the risk of transmission, will have no right to interfere with the mode of transportation or transfer used.

Illustration 2

In the facts given in Illustration 1, the payment for the repair is to be made to Hamburg.

D. Other obligations

As far as non-monetary obligations are concerned, the place of performance is normally the debtor's place of business. This is in conformity with the general principle that in cases of doubt the debtor is assumed to have undertaken the least burdensome obligation.

E. The "place of business"

It is difficult to give an exact definition of "place of business". In most cases it is a party's permanent and regular place for the transaction of general business and not a temporary place of sojourn during sales negotiations.

Illustration 3

Seller A wants to make a sales drive in country B and hires salesrooms in a hotel in the capital of B for a week. From these rooms it solicits orders from buyers. Thereafter the salesrooms are closed down. A has not had a place of business in the capital of B.

F. Several places of business

If a party at whose place of business performance is to be made has more than one place of business, the place of performance is that which has the closest connection with the obligation. The word "party" here refers to a party to the debtor/creditor relationship: it may, depending on the facts, be either the debtor or the creditor.

Illustration 4

A firm has two places of business – a headquarters where legal and other paperwork is done and a factory where manufacturing and delivery take place. It concludes a complicated contract, requiring a lot of negotiation over several weeks and many meetings at the headquarters, for the manufacture of a piece of machinery. The first place of business, the headquarters, has more connection with the contract. The second place of business, the factory, has more connection

with the firm's obligation under the contract. It is the second place of business where the machinery is to be produced.

G. Habitual residence

If a party at whose place of business performance would normally be made has no place of business, or if the obligation relates to a non-business matter, performance is to be effected at that party's habitual residence. Habitual residence is a "factual" not a "legal" concept. A person's habitual residence is at the place where that person actually lives, regardless of whether the residence is lawful, and whether the person sometimes goes to another place to stay for some time, provided that the person normally returns to the first place, see Resolution 72 of the Council of Europe of 18 January 1972.

I. Change of the place of business or habitual residence

The place of performance is the party's place of business (or habitual residence) at the time when performance falls due. However, if the party causes an increase in the cost of performance by the other party by changing a place of business (or habitual residence) between the time when the obligation was incurred and the time when performance falls due, that party must bear the increase. This is provided for by paragraph (3) of the Article. In assessing the impact of this provision it must be borne in mind that it operates only in cases to which paragraph (1) applies. It has no effect in the many normal cases where the place of performance is determinable from the terms regulating the obligation. A party who intends to change a place of business can easily displace paragraph (3) by making it clear at the time of contracting that performance will be due at the new place of business. It must also be borne in mind that a creditor who causes a debtor's non-performance (as might sometimes happen in the case of an uncommunicated change in the place where performance is to be made) has no remedy for that non-performance. (III – 3:101 (Remedies available) paragraph (3)).

III.–2:102: Time of performance

(1) If the time at which, or a period of time within which, an obligation is to be performed cannot otherwise be determined from the terms regulating the obligation it must be performed within a reasonable time after it arises.

(2) If a period of time within which the obligation is to be performed can be determined from the terms regulating the obligation, the obligation may be performed at any time within that period chosen by the debtor unless the circumstances of the case indicate that the creditor is to choose the time.

COMMENTS

A. Significance

The time for performance has significance in several connections. An early performance by a party may be, and a late performance is almost always, a non-performance of an

obligation. A party who is to receive performance which is duly tendered at the time for performance and who does not do so at that time will often bear the risk of performance not being effected.

B. Time determinable from the terms regulating the obligation

If a time for performance is otherwise determinable from the terms regulating the obligation, performance must be made at that time. This may be a date which is fixed by the calendar, for instance "delivery on October 15", or it may be otherwise determined.

Illustration 1

A and B have agreed that B will begin to harvest A's crop one week after A has called for it. The time is determinable from the contract.

C. Performance within a period of time

It may also occur that under the terms regulating the obligation the time of performance is to be within a period of time or by a certain time. In such a case it goes without saying that performance is to be made within that time. Paragraph (2) deals with the question of which party may choose the actual time when performance is to be made within the period. Normally the choice is the debtor's but the circumstances may indicate otherwise.

An example of where the time for performance is to be determined by the creditor is the f.o.b. sale where delivery is to be made during a period of time. Here it is for the buyer to provide the vessel (see INCOTERMS 1990 f.o.b. under B7) and thus decide the date when the goods will be received on board the ship.

It may follow from the circumstances of the case that the period of time fixed for the performance begins as soon as the contract is made and as soon as the creditor - or in an appropriate case the debtor - requires performance.

Illustration 2

A makes an agreement with bank B for a cash-credit in favour of A up to €100,000. The agreement does not mention anything about when A can begin to draw money under the credit, but it follows from the circumstances that A can start drawing at once.

D. Performance within reasonable time

If no time when, or period within which, performance is to take place is otherwise determinable from the terms regulating the obligation, performance is to be made within a reasonable time after the obligation arises. What is a reasonable time is a question of fact depending upon such factors as the nature of the goods or services to be supplied. In the case of a monetary obligation it will not be reasonable to expect performance before the amount has been quantified and, in some cases, an invoice rendered.

III.-2:103: Early performance

(1) A creditor may reject an offer to perform before performance is due unless the early performance would not cause the creditor unreasonable prejudice.

(2) A creditor's acceptance of early performance does not affect the time fixed for the performance by the creditor of any reciprocal obligation.

COMMENTS

A rule to the effect that a debtor may always perform the obligation early would not meet the needs of modern contractual relations. Usually the performance is scheduled in accordance with the creditor's activities and availability and an earlier performance may cause the creditor extra expense or inconvenience.

Illustration 1

A sells to B 10 tons of perishable goods. The date of delivery provided in the contract is October 1. Since the ship on which the goods were loaded arrives at the place of destination earlier than expected, A asks B to take delivery of the goods on September 20. B is entitled to refuse the earlier performance.

On the other hand, although some of the laws always allow the creditor to decline to receive early performance, there is no reason to allow this when the creditor will not suffer any inconvenience through early performance and has no other legitimate interest in refusing.

Illustration 2

The facts are the same as in Illustration No. 1, except that B has storage room available and A is ready to cover the expenses and to carry the risk for the storage of the goods during the period from September 20 to October 1. B must accept the earlier performance, having no legitimate interest in refusing.

The rule requiring acceptance of an early tender if it would not cause the creditor unreasonable prejudice will usually apply in the case of monetary obligations, where the creditor faces no prejudice in receiving the money before the expected time, provided that an earlier payment does not affect the interest due.

Illustration 3

The date for the payment of the price fixed in a contract is July, 1. In order to avoid late payment, the debtor instructs its bank to transfer the funds to the creditor's account well in advance. The price is credited to the creditor's account on June 20. The creditor may not refuse the payment.

A party's acceptance of an earlier performance does not affect the time fixed for the performance of that party's own obligation, even if the other party's right to withhold performance is lost.

Illustration 4

The facts are the same as in Illustration 2 with the addition that payment is to be made at the time agreed for delivery on October 1 when the goods are to be handed over to B. B is not obliged to pay the price when he receives the goods on September 20. A cannot withhold the goods because it is not paid on September 20.

This is, however, only a default rule. The terms regulating the creditor's reciprocal obligation may provide for it to be performed at a time which is to be determined by reference to the actual time of the debtor's performance even if that is early.

III.-2:104: Order of performance

If the order of performance of reciprocal obligations cannot be otherwise determined from the terms regulating the obligations then, to the extent that the obligations can be performed simultaneously, the parties are bound to perform simultaneously unless the circumstances indicate otherwise.

COMMENTS

Where there are reciprocal obligations it must be determined whether the parties are to perform their obligations simultaneously or whether one is to perform before the other.

In many cases the matter will be resolved by the terms regulating the obligations. It will often be expressly or tacitly agreed, for example, that one party to a contract must perform before the other. Usages and practices may be particularly important. In contracts for services it is common to find the custom, "work first, payment later", which may reflect the fact that the employer is a better credit risk than the service provider or may simply be a reflection of market power or social standing.

Illustration 1

A employs B to spend three afternoons a week tending the garden of A's villa. The time for payment is not discussed when the contract is made. B demands payment in advance. A may refuse to pay B until each afternoon's work has been done.

There may, however, be a usage to the effect that A can refuse to pay in advance.

Illustration 2

C books theatre tickets in advance over the phone and comes to collect them from the box office. There will almost certainly be a usage to the effect that the theatre may demand payment before A is admitted to the show.

Even where simultaneous performance is feasible there may be a usage to the effect that one party must perform before the other. Thus it is possible for food in a restaurant to be handed over in exchange for an immediate cash payment, as happens in some cheaper restaurants and bars; but in other types of restaurant the usage may be that the customer is obliged to pay only after the meal has been finished.

This Article provides a default rule for the situation where the question of the order of performance is not solved by the terms regulating the obligations. The default rule is to the effect that, where performances can be rendered simultaneously, the parties are in general bound to perform simultaneously. This is because the party who is to perform first will necessarily have to extend credit (in one form or another) to the other party, thereby incurring a risk that the other will default when the time for the counter-performance comes. This additional risk is avoided if the performances are made simultaneously. Thus it is the general rule in sales contracts that, unless otherwise agreed, delivery and payment are to be simultaneous.

However, simultaneous performance is often impracticable. A person employing a builder cannot realistically be expected to pay the builder brick by brick. Either the employer must pay in advance or, as is more usual, the builder must complete some or all of the work before payment. The Article does not provide a rule as to which party should perform first if simultaneous performance is not appropriate. The variety of circumstances is too great for this to be practical. Almost every general rule would require many exceptions. Sometimes the very nature of the obligations will provide the answer. For example, an obligation to co-operate in order to enable a main obligation to be performed will, of its very nature, fall to be performed first. In contractual cases the gap caused by the absence of a default rule may have to be filled by the creation of an implied term, having regard in particular to the nature and purpose of the contract; the circumstances in which the contract was concluded; and the requirements of good faith and fair dealing.

Illustration 3

Hamlet engages a troupe of players to perform at his country house. Nothing is said about when payment is due. Whether the players may demand payment in advance will depend on usages in the country or previous practices between the parties. If there are none, the question will depend on other factors such as whether the play to be performed had to be specially written and rehearsed.

III.–2:105: Alternative obligations or methods of performance

(1) Where a debtor is bound to perform one of two or more obligations, or to perform an obligation in one of two or more ways, the choice belongs to the debtor, unless the terms regulating the obligations or obligation provide otherwise.

(2) If the party who is to make the choice fails to choose by the time when performance is due, then:

(a) if the delay amounts to a fundamental non-performance, the right to choose passes to the other party;

(b) if the delay does not amount to fundamental non-performance, the other party may give a notice fixing an additional period of reasonable length in which the party to choose must do so. If the latter still fails to do so, the right to choose passes to the other party.

COMMENTS

This provision lays down some rules for the not infrequent situations where a debtor must perform one of alternative obligations or an obligation may be performed in one of two or more ways. It can often be difficult to distinguish between these two situations but that does not matter because the Article lays down the same rules for both. The basic rule is that the debtor may choose which alternative to perform. However, this is only a default rule. The terms regulating the obligations (or the obligation, if there is only one) may indicate that it is the creditor who is to make the choice.

Illustration 1

A contract provides that X must by a certain date either pay Y €1000 or remove certain rubbish from Y's land. This is a case of alternative obligations and the default rule is that X can choose.

Illustration 2

A contract provides that X must clear Y's land of bushes by a certain date either by uprooting them or by cutting them down to ground level and poisoning the roots. This is a case where there is one obligation (to clear the land) but alternative methods of performing it. Again the default rule is that X can choose.

If the person who has the right to choose does not exercise the right within a reasonable time, especially after having been asked to do so by the other party, the right to choose may pass to the other party. The point at which the right to choose will pass depends on how serious the delay is in the circumstances. If it is fundamental the choice passes to the other party; if it is not, the other party can serve a notice fixing a period of reasonable length for the choice to be made. If it is still not made by the end of that period then paragraph (3) makes the choice pass to the other party.

III.-2:106: Performance entrusted to another

A debtor who entrusts performance of an obligation to another person remains responsible for performance.

COMMENTS

A. General

Under modern conditions, many obligations are not performed in fact by the debtor personally. This provision deals with one aspect of this modern division of labour, namely the debtor's responsibility for non-performance. Two other aspects, namely the imputation of actual or constructive knowledge as well as of certain states of mind of persons assisting in the performance of the contract, are dealt with by an earlier Article.

B. Purpose

The basic principle is that if the debtor does not perform the obligation personally but entrusts performance to a third person, the debtor remains nevertheless responsible for the proper performance of the obligation vis-à-vis the creditor. The internal relationship between the debtor and the third person is irrelevant in this context. The third person may be subject to instructions of the debtor, such as an employee or an agent; or may be an independent subcontractor.

III.-2:107: Performance by a third person

(1) Where personal performance by the debtor is not required by the terms regulating the obligation, the creditor cannot refuse performance by a third person if:

- (a) the third person acts with the assent of the debtor; or*
- (b) the third person has a legitimate interest in performing and the debtor has failed to perform or it is clear that the debtor will not perform at the time performance is due.*

(2) Performance by a third person in accordance with paragraph (1) discharges the debtor except to the extent that the third person takes over the creditor's right by assignment or subrogation.

(3) Where personal performance by the debtor is not required and the creditor accepts performance of the debtor's obligation by a third party in circumstances not covered by paragraph (1) the debtor is discharged but the creditor is liable to the debtor for any loss caused by that acceptance.

COMMENTS

A. Scope

This Article addresses the questions, under what conditions does performance of a debtor's obligation by a third person constitute due performance in relation to the creditor

who cannot then refuse performance, and under what conditions does the performance by a third person discharge the debtor vis-à-vis the creditor.

Nothing in the Article relieves the creditor of any obligations towards the debtor.

B. When will a tender constitute performance?

The third person making the performance may be acting on behalf of the debtor as the debtor's representative. In that situation the legal position is the same as if the debtor were performing. Even in the absence of representation, however, a third party who performs is often acting with the assent of the debtor. In such cases paragraph (1)(a) provides that the creditor cannot refuse performance, unless the terms regulating the obligation require personal performance.

However, performance by a third person may also be made without the volition of the debtor. The third person may have a legitimate interest in doing so. A surety pays a debt in order to avoid costly proceedings against the debtor which eventually the surety will have to pay. A tenant pays the mortgage in order to avoid a forced sale of the property. In the interests of the family, a wife pays the debt of her husband for which she is not liable. A parent company pays the debt of its subsidiary to save the latter's credit rating. In these cases it seems sensible to permit payment by the third person even though this is not allowed under the laws of all the Member States (where unauthorised payment by the third person will not have the effect of discharging the debtor). So paragraph (1)(b) has the effect that the creditor cannot refuse performance by the third person provided that the debtor has failed to perform when performance fell due or it is clear that the debtor will not perform at the time when it falls due.

C. Is the debtor discharged?

Due performance by the third person who is entitled to perform discharges the debtor. This is the effect of paragraph (2). Of course, the debtor will not be discharged to the extent that the third party takes over the creditor's right by assignment or subrogation.

It follows from the Article that the debtor remains responsible if a third person who has promised to perform and who has got the debtor's assent to performance fails to perform or makes a defective tender. Where performance has been undertaken or carried out by a third person who has a legitimate interest in performance the debtor will also remain responsible if the third person fails to tender performance when it is due, or if the tender is refused because it is defective. The debtor will not be excused for a failure to perform by a third person unless the third person's non-performance was due to an impediment which would also have excused the debtor.

A creditor who refuses to accept a performance by a third person made in pursuance of paragraph (1) will normally have failed to perform a reciprocal obligation and will be precluded from exercising any of the remedies for non-performance.

D. When may a tender be refused?

There are, however, situations where the creditor is entitled to refuse performance by a third party. Such performance may be excluded by the terms regulating the obligation. There are also situations where it follows from the nature or purpose of the obligation that it cannot be performed vicariously.

Where in contracts for the performance of personal services it can be inferred that the debtor has been selected to perform because of skill, competence or other personal qualifications, the creditor may refuse performance by a third person. However, if it is usual in the type of contract to allow delegation of the performance of some or all of the services, or if this can be done satisfactorily by third persons, the creditor must accept such performance.

Where the third person cannot show any assent by the debtor or any legitimate interest the creditor is entitled to refuse the tender of performance. Thus the creditor can refuse payment from a person who attempts to collect claims against the debtor. If the debtor has not assented to the performance the creditor may also refuse performance by a friend of the debtor whose motive is unselfish.

E. Where creditor voluntarily accepts performance by third party

Paragraph (3) deals with the situation where the contract does not require personal performance by the debtor but the creditor, although not bound to do so, voluntarily accepts performance of the debtor's obligation by a third party. In such cases it would be contrary to the requirements of good faith and fair dealing to allow the creditor to continue to hold the debtor liable. On the other hand there may be cases where the debtor suffers some prejudice as a result of the creditor's acceptance of performance by a third party. The paragraph therefore provides that the debtor is discharged but that the creditor is liable for any loss suffered by the debtor as a result of the creditor's acceptance of performance.

F. Recourse against the debtor

Whether the third party who discharges the debtor's obligation has any recourse against the debtor will depend on the circumstances and on other rules which may be applicable. If the third party is the debtor's representative then their internal relationship will regulate recourse. In other cases where the third party pays with the debtor's assent the matter may be regulated by a contract between the third party and the debtor. In certain other cases special subrogation rules applicable to particular relationships may apply. In yet others the rules on benevolent intervention may come into operation. Finally, there may be cases where the law on unjustified enrichment will apply. It should be noted, however, that under the rules on that subject a person who voluntarily, and without error, confers a benefit on another cannot normally recover.

III.-2:108: Method of payment

(1) Payment of money due may be made by any method used in the ordinary course of business.

(2) A creditor who accepts a cheque or other order to pay or a promise to pay is presumed to do so only on condition that it will be honoured. The creditor may not enforce the original obligation to pay unless the order or promise is not honoured.

COMMENTS

A. General remarks

Payment is not only made by legal tender but also by bank transfer, handing over of a cheque and in many other ways. The development of new techniques for payment must not be prevented by a detailed enumeration of possible manners of payment. It is in the general interest of business to allow payment to be made in any manner which is currently being used and is easy, quick and reliable. Without special permission the debtor can pay in such manner, e.g. by cheque, and the creditor is bound to accept it (see on this specific way also paragraph (2)).

B. Manner of payment

Many national laws provide that payment must be made by legal tender and that the creditor is not entitled to demand any other method of payment except where a contract so provides. However, the debtor may prefer another manner of payment, provided this is in conformity with the ordinary course of business. The creditor must be protected against a surprising, unusual or burdensome manner of payment.

Illustration 1

A owes B €5000. As A wants to annoy B, A takes 500,000 pieces of one cent and sends them to B. Since it is not in the ordinary course of business to pay such a large sum by such a small unit, A is not allowed to make payment in this manner.

What manner is usual depends on the nature of the transaction involved and on the usages prevailing at the place of payment. The creditor does not have the right unilaterally to demand or refuse any particular manner.

C. Acceptance of promise to pay or order to pay conditional only

It often occurs that the creditor, in order to accommodate the debtor, accepts in lieu of cash a cheque, a bill of exchange, or some other promise to pay or order to a third party to pay. In all these cases the creditor generally does not wish to run the risk that the cheque or other claim for payment will not be honoured. Therefore paragraph (2) sentence 1 makes it clear that the original right to payment subsists until satisfaction of the substituted performance has in fact been achieved. If this is not done the creditor may enforce the underlying right. But the creditor cannot proceed with the latter until the substituted performance becomes due and remains unperformed (paragraph (2) sentence 2).

Illustration 2

A owes B €3000. A accepts B's request to give it a promissory note payable two months later. B's remedies for non-performance of the original obligation are suspended until the promissory note is due but revive if the note is dishonoured (see Comment D).

As paragraph (2) sentence 1 establishes a rebuttable presumption, parties may expressly or impliedly stipulate otherwise.

D. Consequences of dishonouring the substituted performance

If the substituted right is not honoured the creditor may proceed with the underlying right to payment as if no substituted performance had been accepted. If interest was due on the debt, it is recoverable. But a creditor who takes a promissory note or another negotiable instrument in substitution for the original obligation to pay will usually find it more efficient to ignore the original obligation and sue on the instrument.

However, a creditor who fails to take any steps necessary to enforce the right received as a substitute cannot then revert to the original remedies for non-performance except to enforce the payment due itself.

Illustration 3

B owes A €5000 from a contract of sale. A has declared that it will accept the €5000 no later than August 1: otherwise it wants to terminate the contractual relationship. On this day B gives A a cheque which A accepts. The cheque is not presented to B's bank until several months later and is not honoured by the bank because of the expiry of the period of presentation. A cannot terminate since it has not presented the cheque in the ordinary way.

III.–2:109: Currency of payment

(1) The debtor and the creditor may agree that payment is to be made only in a specified currency.

(2) In the absence of such agreement, a sum of money expressed in a currency other than that of the place where payment is due may be paid in the currency of that place according to the rate of exchange prevailing there at the time when payment is due.

(3) If, in a case falling within the preceding paragraph, the debtor has not paid at the time when payment is due, the creditor may require payment in the currency of the place where payment is due according to the rate of exchange prevailing there either at the time when payment is due or at the time of actual payment.

(4) 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.

COMMENTS

A. Definitions

Three different currencies may be involved in an international contract.

The currency of account indicates in which currency the primary payment obligation, i.e. typically the price, is measured. The parties or the circumstances usually clearly indicate this currency.

The agreed currency of payment may and often does, on grounds of convenience, differ from the currency of account. It is one agreed upon by the parties (paragraph (1)). Absent such an agreement, the currency of account will normally be the currency of payment.

The currency of the due place of payment may differ from the agreed currency of payment and become relevant under certain circumstances (paragraphs (2)-(3)).

Illustration 1

A merchant in Colombia sells a quantity of coffee for 100,000 US\$ (currency of account) to a trader in London. It is agreed that payment of the purchase price be made in euros (agreed currency of payment) to the seller's account at a bank in Geneva (Swiss francs being the currency of the due place of payment).

B. Payment in the agreed currency of payment

This is clearly a matter of great practical importance and one on which it is highly desirable to have uniformly recognised rules. The laws of the Member States currently diverge to some extent. The rules laid down in this Article are based on two widely adopted uniform laws – the .

The rule of the Article starts from the assumption that in the first place the creditor may require and the debtor must make payment in the agreed currency of payment, i.e. the currency in which the obligation to pay is expressed. This is but a consequence of the creditor's right to require performance. Whether the courts at the place of payment or elsewhere are willing to give judgment in a currency which is foreign to them, is a matter of procedure; it is not affected by these rules.

C. Payment in the currency of the due place of payment

If a monetary obligation is expressed in another currency than that of the due place of payment, the debtor may wish to make payment in the local currency; usually this is also in the creditor's interest. The rule of paragraph (2) presupposes that the agreed currency of payment and the currency of the due place of payment differ.

Illustration 2

A Canadian manufacturer sells machines to a foreign buyer for a purchase price of 540,000 Canadian \$ but it is provided that the purchase price of \$540,000 is to be paid in London.

Two basic issues arise: First, does either party have the right to effect such a conversion, or does only one have such a right or even a duty to effect the conversion? Second, if so, which rate of exchange is to apply? The latter question is of special interest if the debtor delays payment and the currency of account, the agreed currency of payment or the currency of the due place of payment has depreciated in the meantime.

D. Right of conversion

The Article adopts the widely accepted rule that the debtor has the option of effecting payment in the currency of the due place of payment rather than in the currency of payment (see Comment A). This is usually practical for both parties.

A creditor who wants to avoid this result must stipulate that payment be made only in the currency of the money of account (or in the agreed currency of payment). This right of the parties to agree on a different solution is stated expressly in paragraph (1).

E. Rate of exchange

The debtor's right of conversion must not be allowed to diminish the extent of the monetary obligation. Consequently, the rate of exchange for the conversion into the currency of payment must be that prevailing at the due place of payment at the date of maturity (paragraph (2)).

This rule also covers the case where payment is made before the date of maturity.

Difficulties arise where the debtor pays after the date of maturity and in the meantime either the currency of account, the agreed currency of payment or the currency at the due place of payment has depreciated. Should the date of maturity or the date of actual payment determine the rate of exchange? Neither solution is fully satisfactory. If after maturity the currency of account has depreciated, the creditor would be disadvantaged if the rate of exchange on the date of payment were selected. If, on the other hand, after maturity the agreed currency of payment or the currency of the due place of payment has depreciated, the creditor would be injured if the debtor were to be allowed to convert at the rate of exchange of the date of maturity, because this exchange rate places the risk of depreciation of the local currency on the creditor.

The guiding principle for an equitable solution ought to be that the defaulting debtor, and not the creditor, must bear the risk if a currency depreciates after the date of maturity of a monetary obligation. A creditor who had been paid in time would bear both the chances and the risks of depreciation and could have avoided any foreseeable currency risk by converting the money received in a weak currency into money of a strong currency. It is

the debtor who, actually or in effect, is speculating by delaying payment. Two solutions may be envisaged.

One would be to select the rate of exchange of the date of maturity and to grant, in addition, a claim for those damages that have been occasioned through currency depreciation during the debtor's delay. However, this route relies on two separate remedies and may entail a duplication of proceedings.

It is therefore preferable to allow a choice of the dates for the rate of conversion, and this choice must be the creditor's. The creditor may choose between the date of maturity and the date of actual payment. This rule is laid down in paragraph (3).

Of course, the parties may agree on a fixed rate of conversion, and such an agreement takes precedence.

F. Exchange restrictions

The rules of the Article may not operate if and insofar as exchange restrictions affect the payment of foreign money obligations. The question as to which country's exchange restrictions must be taken into account is not addressed.

G. Currency not expressed

Paragraph (4) deals with the problem which arises if the contract does not express any currency. For example, it may just refer to a price to be fixed by a third person without mentioning any currency. In such circumstances the rule provided by paragraph (4) is that payment must be made in the currency of the place where payment is to be made.

III.-2:110: Imputation of performance

(1) Where a debtor has to perform several obligations of the same nature and makes a performance which does not suffice to extinguish all of the obligations, then subject to paragraph (5), the debtor may at the time of performance notify the creditor of the obligation to which obligation the performance is to be imputed.

(2) If the debtor does not make such a notification the creditor may, within a reasonable time and by notifying the debtor, impute the performance to one of the obligations.

(3) An imputation under paragraph (2) is not effective if it is to an obligation which is not yet due, or is illegal, or is disputed.

(4) In the absence of an effective imputation by either party, and subject to the following paragraph, the performance is imputed to that obligation which satisfies one of the following criteria in the sequence indicated:

- (a) the obligation which is due or is the first to fall due;*
- (b) the obligation for which the creditor has the least security;*

- (c) the obligation which is the most burdensome for the debtor;*
- (d) the obligation which has arisen first.*

If none of the preceding criteria applies, the performance is imputed proportionately to all the obligations.

(5) In the case of a monetary obligation, a payment by the debtor is to be imputed, first, to expenses, secondly, to interest, and thirdly, to principal, unless the creditor makes a different imputation.

COMMENTS

A. The problem

Sometimes a party is obliged, not necessarily contractually, to accomplish two or more performances of the same nature - in particular, to pay money. If a performance does not suffice to meet all these obligations, the question arises which obligation has been extinguished by the performance, i.e. to which obligation such performance is to be imputed. The question may become relevant if different securities have been created for the different obligations, or if they bear interest at different rates, or if the periods of prescription expire at different dates. This Article sets out clear rules for imputation, reflecting what is found in the laws of the Member States, which show only minor variations.

B. Debtor's right to impute performance to a particular obligation

The generally accepted principle is that the debtor may at the time of payment expressly or impliedly declare to which obligation the payment is to be imputed.

Illustration 1

Bank B grants to A a loan of €2000 for buying a Peugeot car and some months later a loan of €2500 for buying another car, a Ford. Security interests are created in both cars for B. When later paying €2000 to B, A may declare that his payment concerns the loan for the Peugeot. B cannot object and the security interest in the Peugeot lapses.

A debtor may distribute a payment among various outstanding obligations, thus liquidating them partially. However, the effects of such partial performance are subject to the general rules on non-performance.

To be effective the debtor's imputation must, in general, be declared to the creditor. Otherwise the latter would not know to which of the several obligations the debtor wishes to impute the performance. Usually, such a declaration must be express. An implied imputation may, however, be inferred from the fact that the debtor paid the exact amount of one of the debts or that the other debts are barred by limitation.

The debtor's right of imputation is limited in two ways. First, an agreement on a mode or sequence of imputation prevails. This is simply a consequence of the parties' right to contract out of default rules.

Illustration 2

A and B, to whom A owes different sums, including interest, agree on a scheme for discharge of A's debts. The payments then made by A are imputed according to the scheme for discharge and not according to declarations which A may make on payment.

Second, the debtor of a sum of money is in certain cases prevented from imputing a payment. Paragraph (5) prescribes that the sequence of imputation is: expenses - interest - principal; the term "interest" covers both contractual and statutory interest. Such sequence even applies if the creditor has accepted a tender of performance in which the debtor has declared a different imputation, unless the creditor has clearly consented to such declaration.

Illustration 3

A owes B €50,000. B starts enforcement proceedings and obtains a judicial mortgage of €50,000 on A's land; the costs of these proceedings are €10,000. A then pays to B €50,000. B accepts this payment but refuses to sign a receipt stating that payment is made on the principal and not the costs. According to paragraph (5) the costs and 40/50 of the principal are discharged. Consequently, the remaining €10,000 are still secured by the mortgage.

C. Creditor's subsidiary right to impute

Where there is no agreed rule of imputation and the performing party fails to impute the performance the law must supply a solution. Basically, there are two different approaches: either the right of imputation is granted to the creditor; or objective criteria are fixed for the imputation. Paragraphs (2) to (4) combine those two approaches but give a preference to the first. According to paragraph (2) the right to impute devolves upon the creditor if the debtor does not impute the performance. But, for the imputation to be effective the creditor must exercise this right within a reasonable time after receiving the performance and must notify the debtor, who has a legitimate interest in knowing which obligations are still outstanding; otherwise the performance is imputed according to paragraphs (4) and (5).

In order to protect the debtor from being prejudiced by the creditor's imputation the latter's choice is further restricted by paragraph (3). The creditor cannot impute the performance to an obligation which is not yet due, which is illegal or which - on whatever grounds - is disputed. If none of the obligations is yet due, imputation is regulated by paragraph (4)(a), the effect of which is that the performance will be imputed to the obligation which will be the first to fall due. This is a reasonable result since the debtor would presumably intend to satisfy that obligation rather than one which is to fall due later.

The creditor is not prevented from imputing performance to an obligation which has prescribed. This follows from the fact that, under these rules, prescription does not extinguish the obligation but merely entitles the debtor to refuse performance.

D. Imputation by law

Where neither the debtor (under paragraph (1)) nor the creditor (under paragraphs (2) and (3)) has validly imputed the performance, the law determines to which obligation a performance is imputed.

Under paragraph (4) the performance is imputed to that obligation which according to the sequence of the criteria is the first to correspond to one of the following criteria:

- a) earlier date of falling due;
- b) less security - this criterion must be interpreted in accordance with its economic bearing: also a debt for which a third person has solidary liability or for which enforcement proceedings can already be started offers more security;
- c) more burdensome character - e.g. producing interest at a higher rate, or a penalty,
- d) earlier date of creation.

Illustration 4

B grants a loan of €240,000 to A, which is guaranteed by C. Later, B grants another loan of €220,000 to A. A pays back to B only €220,000. B may sue C for €240,000 because according to paragraph (4) (b) the payment of €220,000 is imputed to the unsecured second loan.

This sequence of criteria is considered to correspond to the interests of both parties. If none of the four criteria leads to imputation of the performance, it is imputed proportionally.

E. Imputation to part of single obligation

The Article presupposes that there are several distinct obligations (cf. paragraph (1)). Some rules of the Article may, however, be extended to cases where partial payment of a single debt needs to be imputed to a proportion of the debt.

Illustration 5

B grants a loan of €240,000 to A which is guaranteed by C up to €150,000. If A repays €50,000, this amount is imputed to the unsecured part of B's loan if neither A nor B makes an imputation.

Whether the Article applies directly if payment is made on a current account being in debit depends on the nature of the current account, which must be determined under the applicable law. The rule applies directly and fully if the (negative) current account is not regarded as an integration (novation) for the individual obligations constituting the account; in this case, the current account in law still consists of the original number of several obligations towards the creditor. If, by contrast, the negative balance of the current account is regarded as constituting an integrated single obligation, the Article does not apply.

III.-2:111: Property not accepted

(1) A person who has an obligation to deliver or return corporeal property other than money and who is left in possession of the property because of the creditor's failure to accept or retake the property, must take reasonable steps to protect and preserve it.

(2) The debtor may obtain discharge from the obligation to deliver or return:

(a) by depositing the property on reasonable terms with a third person to be held to the order of the creditor, and notifying the creditor of this; or

(b) by selling the property on reasonable terms after notice to the creditor, and paying the net proceeds to the creditor.

(3) Where, however, the property is liable to rapid deterioration or its preservation is unreasonably expensive, the debtor must take reasonable steps to dispose of it. The debtor may obtain discharge from the obligation to deliver or return by paying the net proceeds to the creditor.

(4) The debtor left in possession is entitled to be reimbursed or to retain out of the proceeds of sale any costs reasonably incurred.

COMMENTS

A. Scope of the rule

This Article deals with a specific form of prevention of performance, namely the creditor's failure to take delivery or to retake corporeal property, other than money, tendered by the debtor. The effect of failure to accept a tender of money is covered by the next Article.

The scope of the provision is fixed in paragraph (1) and comprises three different situations. In the first a party who is obliged to deliver corporeal property (e.g. under a contract of sale) has made a tender conforming to the terms regulating the obligation but the other party refuses to take delivery. In the second situation the party to whom delivery was to be made has received the property but has lawfully rejected it, and the other party fails to retake it. In the third situation an obligation has been lawfully terminated and a party who had received property under it has then to return the property to the other party. If the other party refuses to accept it, the present Article applies.

For the application of the Article it is irrelevant whether or not the refusal to accept property is a non-performance of an obligation.

The laws of the Member States typically regulate the situations covered by this Article by scattered and fragmentary rules. In combining in one rule several factual situations where a party has not accepted property, the Article uses a new and original approach which reflects both what is to be found in the national laws and also what will be recognised as commercial good practice.

B. Protection and preservation of the property

Where this provision applies, the party who is unwillingly left in possession of property is not on that account entitled to abandon the goods or wantonly to leave them exposed to loss, damage or theft. The party must take reasonable steps for their protection, e.g. by taking them back or depositing them in a store or warehouse (paragraph (2)).

C. Perishables and goods expensive to preserve

In the case of perishables, the obligation to protect encompasses sale of the perishables where they are in danger of deteriorating. The same applies if the expenses of preserving the goods are unreasonably high, i.e. disproportionate to the value of the goods; this covers also the case where the goods take much space which is urgently needed by the debtor. In both cases the party must take reasonable steps for disposition, depending on the value of the goods on the one hand and the trouble and expense of finding a favourable opportunity for sale on the other hand (paragraph (3)).

D. Legal consequences

The Article imposes an obligation to protect and preserve the goods. However, the party left in possession of them is not relieved from the original obligation to deliver or return them.

If the party left in possession wishes to be freed from the obligation to deliver, or to return, the property or its substitute must be made available to the other party. The steps which can be taken to achieve this purpose are prescribed in paragraph (2) for property in general and in paragraph (3) sentence 2 for perishables and equivalent goods.

E. Discharge of party left in possession

In paragraph (2) two ways are set out by which the party left in possession of property (the debtor) may be discharged from the obligation to deliver or to return the property.

The debtor may deposit the property on reasonable terms with a third party to be held to the order of the creditor. The debtor can recover under paragraph (4) all storage charges reasonably incurred. In most cases, the deposit is likely to be a prelude to the debtor's exercise of the power of sale under sub-paragraph (b), for the debtor will be responsible

to the depositary for the latter's charges and may find it impossible to recover these from the creditor.

Alternatively, the debtor may sell or otherwise dispose of the object on reasonable terms. The interests of the creditor are protected by requiring that the debtor normally act only after reasonable notice; in the case of perishables this notice may be very short or no notice may be needed at all. The debtor must then account to the creditor for the net proceeds of the disposal. The debtor may be entitled under the applicable law to set off a claim against the creditor's entitlement to the net proceeds (e.g. for damages for breach of contract).

If the debtor had already sold the goods according to paragraph (2) sentence 1, discharge from the obligation to deliver or return may be obtained by paying the net proceeds (see paragraph (4)) of the sale to the creditor.

F. Other remedies unaffected

If by not taking delivery the creditor fails to perform an obligation, the debtor is entitled to exercise any of the remedies available for non-performance, including damages.

III.–2:112: Money not accepted

(1) Where a creditor fails to accept money properly tendered by the debtor, the debtor may after notice to the creditor obtain discharge from the obligation to pay by depositing the money to the order of the creditor in accordance with the law of the place where payment is due.

(2) Paragraph (1) applies, with appropriate adaptations, to money properly tendered by a third party in circumstances where the creditor is not entitled to refuse such performance.

COMMENTS

A. Explanation

This provision enables the debtor in a monetary obligation, after notice, to be freed from the obligation to pay by depositing the money in any manner authorised by the law of the place for payment, e.g. by paying it into court. (The question of which methods of payment are authorised falls outside the scope of these rules.) This possibility is now recognised in many, though not all, Member States and is clearly convenient to the debtor while (because of the conditions imposed) posing little or no risk to the creditor.

The deposit must be to the order of the creditor so that the creditor obtains the right to dispose of the money deposited. The notice to the creditor must be reasonable both with

respect to the method of transmission and with respect to the time given to the first party to reply.

B. Scope of application

The provision applies to any obligation to pay whether or not contractual. So it applies, for example, both to an obligation to pay the price under a contract for the sale of goods and to an obligation to pay damages. The tender of payment must have been properly made - i.e. it must have been in conformity with the terms regulating the obligation to pay.

For the application of the Article it is irrelevant whether or not the refusal to accept money is a non-performance of an obligation.

C. Payment by a third person

There are situations where an obligation which does not require personal performance can be performed by a third person and where the creditor cannot refuse performance. The payment of money will not usually require personal performance. Paragraph (3) of the Article covers this situation.

III.-2:113: Costs and formalities of performance

(1) The costs of performing an obligation are borne by the debtor.

(2) In the case of a monetary obligation the debtor's obligation to pay includes taking such steps and complying with such formalities as may be necessary to enable payment to be made.

COMMENTS

The performance of obligations usually entails costs and often involves complying with formalities. Transportation, money transfers, government licences, risk insurance, etc. will all have to be paid for. Paragraph (1) lays down that such costs are to be borne by the debtor, the performing party. Paragraph (2) particularises this for the case of monetary obligations, making it clear that the debtor bears the responsibility of taking such steps and complying with such formalities as may be necessary to enable payment to be made. The rule is commonly found in relation to sale (see IV.A.-3:202 (Formalities of payment)) but is included here because it is of a more general nature.

Illustration

A orders a book from Publishers B, located in another country, after B has stated a price for the book knowing that A resides in another country. The Publishers may not invoice A extra for the costs of mailing the book, unless this was agreed. Likewise, A has to bear the costs of paying for the book through an international money order or other means of payment.

III.–2:114: Extinctive effect of performance

Full performance extinguishes the obligation if it is:

- (a) in accordance with the terms regulating the obligation; or*
- (b) of such a type as by law to afford the debtor a good discharge.*

COMMENTS

It is obvious that full performance in accordance with the terms regulating the obligation will extinguish the obligation. It is the corollary which is important: performance which is not full or not in conformity with the terms regulating the obligation will not extinguish the obligation. This, however, is subject to the qualification that there are various situations where these rules provide for the debtor to obtain a good discharge even if performance is not strictly in accordance with the obligation. For example the rules on assignment sometimes enable the debtor to obtain a good discharge by paying the “wrong” creditor in good faith. And III.–2:107 (Performance by a third person) provides for performance by a party other than the debtor to be effective in some situations. Other rules of this nature are to be found in the Chapter on Plurality.

CHAPTER 3: REMEDIES FOR NON-PERFORMANCE

Section 1: General

III.–3:101: Remedies available

- (1) If an obligation is not performed by the debtor and the non-performance is not excused, the creditor may resort to any of the remedies set out in this Chapter.*
- (2) If the debtor’s non-performance is excused, the creditor may resort to any of those remedies except enforcing specific performance and damages.*
- (3) The creditor may not resort to any of those remedies to the extent that the creditor caused the debtor’s non-performance.*

COMMENTS

A. Remedies available

The remedies available for non-performance of an obligation depend upon whether the non-performance is not excused, is excused due to an impediment or results from behaviour of the other party. This represents the common core of the laws of the Member

States, though some reach broadly similar results through a rather different conceptual structure.

Non-performance which is not excused. A non-performance which is not excused may give the creditor the right to claim performance - recovery of money due or specific performance - to claim damages, to withhold performance of a reciprocal obligation, to terminate the contractual relationship in whole or in part and to reduce the price (if a price is payable). If a party violates an obligation to receive or accept performance the other party may also make use of the remedies just mentioned.

Non-performance which is excused. A non-performance which is excused due to an impediment does not give the creditor the right to claim specific performance or to claim damages. However, the other remedies may be available.

Illustration 1

A has let his land to B for ten years and B has undertaken to grow vines on the land. B plants vines but the vines die from phylloxera which invades the region. Although B's failure to grow vines is excused, and B therefore is not liable in damages, B has not performed his obligations under the contract and A can terminate the lease, with the effect that the whole contractual relationship will come to an end.

Illustration 2

A in Torino has undertaken to lease a motor lorry to B in Grenoble from December 1 and to deliver it on that day in Grenoble. The lorry is held up at the frontier due to a road block unexpectedly effected by French farmers, and arrives in Grenoble on December 15. Although A is not liable for the delay, B can withhold payment until delivery is made of the lorry, and may then deduct 15 days rent from the sum to be paid.

Non-performance wholly or partially caused by the creditor. The fact that the non-performance is caused by the creditor's act or omission has an effect on the remedies open to the creditor. This is expressed by the third paragraph of the text. It would be contrary to good faith and fair dealing for the creditor to have a remedy when responsible for the non-performance.

The most obvious situation is the so-called *mora creditoris*, where the creditor directly prevents performance (e.g.: access refused to a building site). But there are other cases where the creditor's behaviour has an influence on the breach and its consequences. For example, when there is an obligation to give information to the other party, and the information given is wrong or incomplete, the contract is imperfectly performed.

Illustration 3

A has contracted to design schools to be built by B in the Tripolis area, and is expecting instructions from B as to the exact location of the schools. Due to

dissensions in its staff, B fails to give the instructions within the stipulated period of time, which prevents A from designing the schools. The non-performance on A's side does not give B the right to exercise any remedy, but A will have a remedy against B.

Illustration 4

The facts are the same as in Illustration 3 except that B's failure to give instructions is due to the fact that the relevant member of B's staff has been killed in an air crash on the way to Libya. Although B is not liable for the failure to instruct A, the non-performance on A's side does not give B any remedies either.

In other cases where there is also a non-performance by the debtor, the creditor may exercise the remedies for non-performance to a limited extent.

When the loss is caused both by the debtor - who has not performed - and the creditor - whose behaviour has partially caused the breach - the creditor should not have the whole range of remedies.

The creditor's contribution to the non-performance has an effect on the remedy "to the extent that the creditor caused the debtor's non-performance". This effect may be total, that is to say that the creditor cannot exercise any remedy, or partial.

Illustration 5

A agrees to carry B's glassware from Copenhagen to Paris but subjects the packages to rough handling. This would have broken some of the glass which is fragile but not some heavy pieces of thick glass. B, however, has not packed any of the glass properly and all is ruined. B can refuse to pay the carriage charges and recover damages in respect of the fragile glass, but not in respect of the heavy glass.

B. Normal remedy for non-performance of monetary obligation

The normal remedy for non-performance of a monetary obligation will be recovery of the sum due plus interest for any delay in payment. However, damages may also be recoverable if there is any further loss.

III.-3:102: Cumulation of remedies

Remedies which are not incompatible may be cumulated. In particular, a creditor is not deprived of the right to damages by resorting to any other remedy.

COMMENTS

A. Cumulation of remedies

Remedies which are not incompatible are cumulative. A party entitled to withhold performance of a reciprocal obligation and to terminate the contractual relationship may first withhold and then terminate. A party who pursues a remedy other than damages is not precluded from claiming damages. This applies in the exceptional case where damages can be claimed in addition to interest under III.-3:101 (Remedies available) paragraph (4). A party who terminates for fundamental non-performance may also claim damages.

B. Incompatible remedies

It is obvious that a party cannot at the same time pursue two or more remedies which are incompatible with each other. So a party cannot at the same time terminate an obligation and claim specific performance. A creditor who has accepted a non-conforming tender, the value of which is less than that of a conforming tender, and who has obtained a reduction of the price corresponding to the decrease in value, cannot also claim compensation for that same decrease in value as damages.

When two remedies are incompatible with each other, the creditor will often have to choose between them, see comment C below.

C. Change of remedy

However, a creditor who has chosen one remedy is not precluded from shifting to another later, even though the later remedy is incompatible with the first elected. If, after having claimed specific performance, the creditor learns that the debtor has not performed or is not likely to do so within a reasonable time, the creditor may terminate for fundamental non-performance. On the other hand, an election of a remedy is often definite and will preclude later elections of incompatible remedies. A party who has terminated a contractual relationship cannot later have a change of mind and claim specific performance of the primary obligation, because by giving notice of termination the creditor may have caused the debtor to act in reliance on the termination. If the debtor has adapted to a claim for specific performance and taken measures to perform within a reasonable time, the creditor cannot change position and terminate for fundamental non-performance. This applies when the defaulting debtor has received a notice fixing an additional time for performance. The rule is in accordance with the widely accepted principle that when a party has made a declaration of intention which has caused the other party to act in reliance on the declaration the party making it will not be permitted to act inconsistently with it. This follows from the general principle of exercising rights and remedies in accordance with good faith and fair dealing.

III.–3:103: Notice fixing additional period for performance

(1) In any case of non-performance of an obligation the creditor may by notice to the debtor allow an additional period of time for performance.

(2) During the additional period the creditor may withhold performance of the creditor's reciprocal obligations and may claim damages, but may not resort to any other remedy.

(3) If the creditor receives notice from the debtor that the debtor will not perform within that period, or if upon expiry of that period due performance has not been made, the creditor may resort to any available remedy.

COMMENTS

Paragraph (1) of this Article is not necessary by itself. Even without the paragraph a creditor could by notice allow the debtor an additional period of time for performance. However the paragraph sets the scene for the rest of the Article.

The main effect of paragraph (2) is that if the creditor has by notice given the debtor an additional period of time for performance, the creditor may not change course without warning and exercise remedies inconsistent with the allowance of extra time – such as enforcing specific performance or terminating the contractual relationship. This could be regarded as a specific example of the requirement to exercise remedies in accordance with good faith and fair dealing. The creditor may, however, withhold performance of reciprocal obligations or even claim damages for any loss already suffered by the delay because these remedies are not inconsistent with the allowance of additional time.

Illustration 1

A company leases a new car to B for 2 years, and B collects it from the company's premises. The car breaks down and B has to have it towed back to the company's premises. The defect in the car amounts to a fundamental non-performance but B tells the company that the car will be accepted if it is fixed within 3 days. B may refuse to pay the rental and may claim damages for any inconvenience in not having the car while it is repaired and for the cost of the tow, but may not demand delivery of another car or terminate for fundamental non-performance unless the car is not repaired and redelivered within the 3 days.

Paragraph (3) makes it clear that the creditor will not lose remedies (e.g. by the lapse of time for the exercise of the remedy of enforcing specific performance) by allowing additional time.

A later Article provides that, where there has been a delay in performance, failure to comply with a notice allowing additional time for performance may give the creditor the right to terminate the contractual relationship in whole or in part. Quite apart from that, however, the notice procedure may be useful. The creditor may not wish to terminate immediately even where the delay or other non-performance is fundamental but may be prepared to accept a proper performance by the debtor provided it is rendered within a

certain period. The procedure set out in the Article permits the creditor to give the debtor a final chance to perform (or to correct a defective performance), without the creditor losing the right to seek specific performance or to terminate if by the end of the period of notice the debtor has still not performed in accordance with the contract. At the same time, however, the rule that the creditor may not seek specific performance or terminate during the period of notice protects the debtor from a sudden change of mind by the creditor. The debtor may have relied on having the period set in the notice in which to perform.

The notice procedure may also be used when a performance is prompt but defective in a way which is not fundamental. In such a case the creditor will not have the right to terminate and serving a notice fixing an additional time for performance will not confer that right. Nonetheless, serving a notice may still perform the useful functions of informing the debtor that the creditor still wants proper performance and of giving the debtor a last chance before the creditor seeks specific performance. In these respects the notice serves the same function as a *mise en demeure* in French law or *Mahnung* in German law.

III.–3:104: Excuse due to an impediment

(1) A debtor's non-performance of an obligation is excused if it is due to an impediment beyond the debtor's control and if the debtor could not reasonably be expected to have avoided or overcome the impediment or its consequences.

(2) Where the obligation arose out of a contract or other juridical act, non-performance is not excused if the debtor could reasonably be expected to have taken the impediment into account at the time when the obligation was incurred.

(3) Where the excusing impediment is only temporary the excuse has effect for the period during which the impediment exists. However, if the delay amounts to a fundamental non-performance, the creditor may treat it as such.

(4) Where the excusing impediment is permanent the obligation is extinguished. Any reciprocal obligation is also extinguished. In the case of contractual obligations any restitutionary effects of extinction are regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) with appropriate adaptations.

(5) The debtor must ensure that notice of the impediment and of its effect on the ability to perform reaches the creditor within a reasonable time after the debtor knew or could reasonably be expected to have known of these circumstances. The creditor is entitled to damages for any loss resulting from the non-receipt of such notice.

COMMENTS

A. General

This Article governs the consequences when an event which is not the fault or responsibility of the debtor prevents the debtor from performing the obligation. It reflects the results that, broadly speaking, are reached in the laws of all the Member States though in some a different conceptual structure is employed. Paragraph (5) does not have an equivalent in many of the laws but is clearly commercially sensible.

The rules in the Article are not mandatory. The parties to a contract may modify the allocation of the risk of impossibility of performance, either in general or in relation to a particular impediment; usages (especially in carriage by sea) may have the same effect. Also, in accordance with the rule that specific provisions prevail over more general provisions, special rules on the passing of risk in particular situations (such as sale of goods) may modify the effects of this Article.

B. Scope

The excuse may apply to any obligation, including obligations to pay money. While insolvency would not normally be an impediment within the meaning of the text, as it is not "beyond the control" of the debtor, a government ban on transferring the sum due might be.

The term "impediment", covers every sort of event (natural occurrences, restraints of princes, acts of third parties).

It is conceivable that an impediment existed, without the parties knowing it, at the time when a contract was concluded. For example, the parties might sign a charter of a ship which, unknown to them, has just sunk. This situation is not covered by the Article but the contract might be avoidable under the rules on mistake.

There is less need for the doctrine of excused non-performance in the case of an obligation which is merely to make reasonable efforts to do something ("*obligation de moyens*"). There will be cases where the debtor makes all reasonable efforts but some unforeseen impediment beyond the debtor's control prevents the result being achieved. In such a case there will not be excused non-performance; there will simply be no non-performance at all. There may also, however, be cases where an impediment prevents the debtor from making reasonable efforts and in such a case the Article may apply.

C. The circumstances of the impediment

The requirements laid down for the operation of the Article are analogous to the traditional requirements for *force majeure*. They are necessarily in general terms, given the great variety of fact situations to which they must apply. It is for the party who invokes the Article to show that the requirements are satisfied.

Outside the debtor's control. First, the obstacle must be something outside the debtor's sphere of control. The risk of the debtor's own activities must be borne by the debtor. Thus the breakdown of a machine under the debtor's control, even if unforeseeable and unpreventable, cannot be an impediment within the article and this avoids investigation of whether the breakdown was really unforeseeable and the consequences unpreventable. The same is true of the actions of persons for whom the debtor is responsible, and particularly the acts of the people the debtor puts in charge of the performance. The debtor cannot invoke the default of a subcontractor unless this was outside the debtor's control - for instance because there was no other subcontractor who could have been employed to do the work; and the impediment must also be outside the subcontractor's sphere of control.

Illustration 1

In consequence of an unexpected strike in the nationalised company which distributes natural gas, a chinaware manufacturer which heats its furnaces only with gas is obliged to interrupt its production. The manufacturer is not liable toward its own clients, if the other requirements of the Article are fulfilled. The cause of non-performance is external.

Illustration 2

The employees of a company unforeseeably go on strike in order to force the management to buy foreign machines which will improve the working conditions. For the time being it is actually not possible to obtain these machines. The company cannot claim as against its customers that the strike is an excuse, as the event is not beyond its control.

There will be no excuse if an unforeseeable event impedes performance of the obligation when the event would not have affected the obligation if the debtor had not been late in performing.

Illustration 3

A French bank, A, is instructed by company B to transfer a sum of money to a bank in country X by 15 July. It has not carried out the instruction by 18 July when all transfers of money between France and X are suspended. Bank A cannot claim to be excused from its obligation to B; the transfer could have been made if it had been done in the time allowed under the contract.

Could not have been taken into account. In the case of an obligation incurred by contract or other juridical act the impediment must also be one that could not have been taken into account by the debtor at the time the obligation was incurred. If it could have been, one may say that the debtor took the risk or was at fault in not having foreseen it. These notions are not applicable in the case of an obligation which arises by operation of law. This is why paragraph (2) is confined to obligations which arise from contracts or other juridical acts.

However, it may be relevant whether the debtor could have taken into consideration not just the event itself but the date or period of its occurrence. A price control for some period may be foreseeable, but it could be an excuse if the period for which it is kept in force was not foreseeable. Equally it is stated that the test is whether the debtor could “reasonably” have been expected to take the impediment into account: that is to say, whether a normal person, placed in the same situation, could have foreseen it without either undue optimism or undue pessimism. Thus in a particular area cyclones may be foreseeable at certain times of year, but could not reasonably be expected to be foreseen at a time of year when they do not normally occur.

Insurmountable impediment. Reasonableness also qualifies the requirement that the impediment must be insurmountable or irresistible. It must be emphasised that both conditions - that the debtor could not have avoided it and could not have overcome it - must be fulfilled before an excuse can operate.

Whether an event could have been avoided or its consequences overcome depends on the facts. In an earthquake zone the effects of earthquakes can be overcome by special construction techniques, though it would be different in the case of a quake of much greater force than usual.

One cannot expect the debtor to take precautions out of proportion to the risk (e. g. the building of a virtual fortress) nor to adopt illegal means (e.g. the smuggling of funds to avoid a ban on their transfer) in order to avoid the risk.

D. Effects

A temporary impediment to performance which fulfils the requirements just set out relieves the debtor from liability for as long as it lasts. This means that the creditor cannot obtain an order for specific performance and cannot recover damages for the non-performance. The creditor can, however, withhold performance of reciprocal obligations or reduce the price payable (if any) or, if the impediment leads to a fundamental non-performance, terminate the contractual relationship.

Illustration 4

If A has leased a warehouse to B and subsequently it is partially destroyed by fire, causing a temporary impediment, B may terminate the lease if occupation of the whole of the premises was an essential part of the contract. If, on the other hand, B does not give notice of termination, B cannot obtain damages for loss of occupation but the rent will be reduced proportionately.

A temporary impediment means not only the circumstances which cause the obstacle but also the consequences which follow; these may last longer than the circumstances themselves. The excuse covers the whole period during which the debtor is unable to perform.

Illustration 5

The warehouse containing a pharmaceutical manufacturer's raw materials is unforeseeably flooded and the raw materials are rendered unusable. The delays in delivering to clients which will be excused include not only the period of the flood itself but also the time necessary for the manufacturer to obtain new supplies.

It may be, however, that late performance will be of no use to the creditor. Therefore the creditor is given the right to terminate provided that the delay is itself fundamental.

Illustration 6

An impresario in Hamburg has engaged a famous English tenor to sing at the Hamburg Opera from 1 to 31 October. The singer catches flu and has to retire to bed (which would constitute an impediment within paragraph (1)); he tells the impresario that he will be unable to come to Hamburg before 10 October. Assuming that the tenor's presence for the whole month is an essential part of the contract, the impresario may terminate for fundamental non-performance. If this is not done, the obligations on both sides remain in force for the remaining period but the tenor's fees will be reduced proportionately.

Equally in the case of a temporary excuse, the creditor can use the procedure of serving a notice fixing an additional period of time for performance with a right to terminate if there is no performance within that period.

If the excusing impediment is permanent the obligation is extinguished (paragraph (4)) The main reason for making extinction automatic in this situation, rather than leaving the matter to the rules on termination by notice for non-performance, is that it would be unnecessary and unrealistic to require the creditor to terminate by notice. It could also be pernicious. Notice of termination for non-performance must be given within a reasonable time. If it is not, the creditor loses the right to terminate. However, this would result in an unfortunate situation in the case of a permanent excusing impediment. The obligation could never be performed and could never be terminated. It would continue to exist in a sort of ghostly state. The cleaner solution is to provide for automatic termination both of the obligation in question and any reciprocal obligation. Any restitutionary effects are regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) with appropriate adaptations. Again, it should be noted that these rules will be subject to any specific rules on the passing of risk. There may be cases where an obligation (e.g. to transfer the ownership of goods) is extinguished but where the reciprocal obligation (e.g. to pay the price) still has to be performed because the risk of destruction has passed to the buyer.

Whether an impediment is temporary or permanent must be assessed in relation to the nature of the obligation. There are cases where late performance would manifestly not be performance at all, whatever the attitude of the creditor to delay. In such cases an

impediment may permanently prevent performance of the obligation even if the cause of the impediment is not itself permanent.

Illustration 7

The tenor in the previous illustration is, two days before the first night of the opera, injured in a car crash and confined to a hospital bed in plaster for at least six weeks. He notifies the impresario immediately. There is a permanent impediment to performance in relation to this obligation (even although his debilitated condition is hopefully not permanent).

If the debtor's obligation is extinguished it follows that any reciprocal obligation of the creditor must also be extinguished. In cases where one of the debtor's obligations is extinguished but the creditor has to pay a global price for performance of all of them the remedy of price reduction may come into play.

Illustration 8

A company is under an obligation to a landowner to plant trees on three islands. One of the islands disappears under the sea as a result of a geological event. The landowner had a reciprocal obligation to pay for the work. If the obligation was to pay a separate sum for the planting on each island then the obligation to pay for the planting on the sunken island is extinguished entirely. If the obligation was to pay a lump sum for the whole work but the landowner is willing to accept performance in relation to the two surviving islands then the landowner can reduce the price under III.-3:601 (Right to reduce price).

It may happen that the extinguished obligation of the debtor is just one of several obligations under a contract and that performance of the remaining obligations has become valueless to the creditor as a result of the extinction of the one obligation. In such a case the creditor will have the option of terminating the whole contractual relationship for fundamental non-performance.

Another reason for providing for the extinction of the obligation, rather than just allowing it to continue in a sort of limbo, is that extinction attracts the provisions of chapter 8 on the restitutionary effects of prematurely ended obligations. At the time when an obligation is affected by a permanent impediment which excuses further performance completely and for ever, one party may have supplied something to the other. The only fair solution may be to require restitution of the benefit or payment of its value. This can most easily and appropriately be achieved by applying the provisions of Chapter 8.

E. Notice by debtor

Paragraph (4) of the Article is an application of the general duty of good faith and fair dealing. The debtor must in effect warn the creditor, within a reasonable time, of the occurrence of the obstacle and of its consequences for the obligation to perform. The notice must, in effect, allow the creditor the chance to take steps to avoid the

consequences of non-performance. It is also necessary in order for the creditor to be able to exercise any right to terminate when performance is partial or late.

Illustration 9

In the example given in illustration 5, the manufacturer must notify its customers of the loss of the raw materials and also of the time it will take to replace them and the probable date for resumption of deliveries.

The reasonable time may be a short one: circumstances may even require immediate notification. The time starts to run as soon as the impediment and its consequences for the performance of the obligation become known (see above); or from when the debtor could reasonably be expected to have known. Good faith may even require two successive notices, if for example the debtor cannot immediately tell what the consequences of the impediment will be.

The sanction for failing to give this notice is liability for the extra loss suffered by the creditor as the result of not being informed; normally the creditor will recover damages.

Illustration 10

In the example given in Illustration 6, if the tenor does not warn the impresario immediately of his unavailability, the latter may recover compensation for being deprived of the chance to obtain a replacement, so reducing his loss.

III.-3:105: Term excluding or restricting remedies

(1) A term of a contract or other juridical act which purports to exclude or restrict liability to pay damages for personal injury (including fatal injury) caused intentionally or by gross negligence is void.

(2) A term excluding or restricting a remedy for non-performance of an obligation, even if valid and otherwise effective, having regard in particular to the rules on unfair contract terms in Book II, Chapter 9, Section 4, may nevertheless not be invoked if it would be contrary to good faith and fair dealing to do so.

COMMENTS

A. General

It is very common for parties to contracts to try to limit their liability by an exclusion or limitation clause. Many such clauses are perfectly reasonable and acceptable. There is no reason why parties should not, in general, allocate the risks of certain events as between themselves and reflect this allocation in the price. Some such clauses may, however, be oppressive and unfair. This problem is dealt with to some extent by the rules in Book II, Chapter 9, Section 4 on unfair contract terms, but those rules do not cover all cases. Often they are confined to terms which are standard terms or not individually negotiated. The

present Article goes further. It adopts two different techniques. Paragraph (1) makes certain types of exclusion or limitation clause void and therefore completely ineffective. Its scope is, however, deliberately very limited. Paragraph (2) comes into operation only if an exclusion or limitation term is valid and otherwise effective. It provides, as a sort of residual protection, that the term cannot be relied on if it would be contrary to good faith and fair dealing to do so. Paragraph (2) is, strictly speaking, unnecessary. The result follows from the general duty to exercise rights in accordance with good faith and fair dealing. It is included, however, because of the practical importance of the subject and because it is useful to make clear the potentially powerful effect of the good faith requirement in this area.

Close equivalents to both paragraphs can be found in the laws of many Member States, but each is somewhat more demanding than the controls the law imposes on exclusion clauses in other Member States. Nonetheless each paragraph represents a balanced approach that seems to be widely accepted within Europe. As to paragraph (1), it is almost impossible to envisage a situation in which the potential victim of intentional or grossly negligent personal injury would wittingly agree that he or she should have no remedy for it, or in which the other party could have any legitimate interest in excluding liability. As to paragraph (2), while a party should be permitted to rely on an exclusion or restriction of other kinds of liability when that is what was genuinely agreed, that should not be the case when, exceptionally, the particular circumstances - typically, the party's own conduct - make it contrary to good faith and fair dealing to do so.

B. Terms excluding or restricting liability for damages for personal injury

Paragraph (1) is based on the consideration that it is always unacceptable for a party to try to contract out of liability for damages for causing personal injury (fatal or non-fatal) intentionally or by gross negligence. Annex 1 provides that there is "gross negligence" if a person is guilty of a profound failure to take such care as is self-evidently required in the circumstances. It is important to note that paragraph (1) does not say that there is liability. Whether or not there is liability will depend on the law and the facts quite apart from the exclusion or limitation clause. There can be cases where there is no liability for causing personal injury intentionally. For example, a doctor who has a contractual obligation to amputate a limb will cause personal injury intentionally but, far from this being a non-performance of an obligation giving rise to liability, it will be the performance of an obligation.

C. Other terms excluding or restricting remedies

Paragraph (2) is very general and covers all terms which in practice prevent the creditor from obtaining the normal remedy. No distinction is drawn between terms which limit responsibility and those which exclude it altogether. It is difficult to distinguish them anyway since a derisory limit on recovery is effectively an exclusion, and there is no good reason for imposing different controls in the two cases.

The limitation of liability may be fixed directly as a figure or by a formula (e.g. so many times the contract price).

Agreed payments for non-performance may operate so as to limit the recovery of the creditor. In this case the creditor can demand full compensation if the requirements of the Article are met.

Illustration 1

The contract for the construction of a factory contains a term imposing liability for €10,000 per week for late completion. The work is completed late because the contractor has deliberately neglected the job in favour of another, more profitable, one. If the loss suffered by the employer amounts to €20,000 per week, the latter may recover this amount despite the term, as for the contractor to invoke it when it has deliberately disregarded the contract would be contrary to good faith and fair dealing (see further below).

Exclusion or limitation terms most frequently concern liability for damages. However, nothing in the Article prevents its application to terms limiting or excluding other remedies for non-performance (termination for fundamental non-performance, reduction of the price, etc.).

D. Contrary to good faith to invoke the term

The criterion applied by paragraph (2) is whether it would be contrary to good faith and fair dealing to invoke the term. The paragraph applies whether or not the term has been individually negotiated and whether or not it was contrary to good faith and fair dealing to include the term in the contract.

It may still be contrary to good faith and fair dealing for the other party to invoke the term, even if it has been individually negotiated and even if it escapes the rules on unfair contract terms, particularly if this is done in circumstances which the first party would not have contemplated, such as a deliberate decision by the party invoking the term to perform the contract in a quite different way not in accordance with its other terms.

Illustration 2

A security firm agrees to send men to check on a customer's premises once an hour during the hours of darkness. It limits its responsibility to the customer. It deliberately decides to send men only every three hours. It would be contrary to good faith and fair dealing to invoke the limitation of responsibility term.

An intentional disregard of the other terms of the contract may make it contrary to good faith to invoke the term even if there was no intention to harm the other party.

It should suffice that the non-performance was committed knowingly.

Illustration 3

A carrier which has undertaken to provide a lorry capable of carrying a refrigerated load at minus ten degrees, but which does not have one, provides a lorry capable of refrigeration only to minus five. The carrier thinks that for the short journey involved this will not matter. The goods are damaged. The contractor cannot rely on a term limiting its liability for damage caused by inadequate refrigeration.

Some breaches, though intentional, may be within the contemplation of the parties as a decision one of them may have to make. Such intentional breaches would not mean that it is contrary to good faith to invoke the term.

Illustration 4

A voyage charter allows a certain number of 'lay days' for the charterer to have the ship loaded and unloaded; if the lay days are exceeded, the charterer must pay damages for demurrage, but the amount is limited to €1,000 per day. As both parties are aware, the loading port is subject to congestion, and the charterer deliberately delays having the ship loaded until after another of its vessels has been loaded. Loading of the chartered vessel is not completed within the lay days. The loss to the owner exceeds the limit set in the demurrage term. Even though the delay by the charterer was deliberate, it is not contrary to good faith for it to invoke the €1,000 per day limit.

It should be noted that the test in the present Article is based on the actual facts, not on the unfairness or otherwise of the term in the abstract. It may be contrary to good faith and fair dealing to include a very broad limitation of liability term when the term has not been negotiated: nonetheless if the same term had been individually negotiated it may not be contrary to good faith and fair dealing to invoke it in a particular situation.

Illustration 5

A contract for the carriage of goods in a refrigerated lorry limits the carriers' liability, in the event of inadequate refrigeration however arising, to €100 per box of food. The food is damaged because the refrigeration machinery, despite proper maintenance, breaks down. If the term were not individually negotiated, it might not be binding on the client as it is capable of limiting liability even when the carrier had been reckless or grossly negligent. If it has been individually negotiated and is therefore outside the rules on unfair contract terms, it does not seem contrary to good faith and fair dealing for the carrier to invoke it on the actual facts.

Compare also II.–7:215 (Exclusion or restriction of remedies) which covers the exclusion or restriction of remedies for mistake and incorrect information.

E. Negotiated term which is still contrary to good faith.

Even though there has been some negotiation over a term, so that it is outside the rules on unfair contract terms, in an extreme case it might still be contrary to good faith to invoke

it. If the party in whose favour the term operated had refused to make more than marginal concessions and the other party had no real choice but to accept, the court may decide under this Article that the term cannot be invoked.

Illustration 6

A seed company offers seed to a farmer on terms that its liability if the seed is defective is limited to returning the contract price. The farmer protests at this but the seed company refuses to amend the term except by adding that, in the event of seed failure, the farmer will be entitled to a 10% discount on the next purchase of similar seed. Other seed companies all take a similar attitude. The seed companies could cover liability in defective seed by insurance; the farmer cannot easily insure against crop failure due to defective seed. The seed supplied is of completely the wrong type and the farmers' crop fails. It is contrary to good faith and fair dealing for the seed company to invoke the term.

In practice mandatory laws on consumer protection will often supersede the rule in paragraph (2) the present Article.

It should not be possible to set aside by agreement the restrictions on the availability of terms under the Article; this exclusion would be contrary to the duty of good faith and fair dealing.

F. The consequences under paragraph (2)

If to invoke the term is found to be contrary to good faith and fair dealing, the term will not operate. Paragraph (2) The Article does not give the court a discretion simply to increase the liability but leaves it to be assessed in accordance with the normal rules, as there is no effective limitation of liability.

III.–3:106: Notices relating to non-performance

(1) If the creditor gives notice to the debtor because of the debtor's non-performance of an obligation or because such non-performance is anticipated, and the notice is properly dispatched or given, a delay or inaccuracy in the transmission of the notice or its failure to arrive does not prevent it from having effect.

(2) The notice has effect from the time at which it would have arrived in normal circumstances.

COMMENTS

A. The dispatch principle for cases of default

The normal rule on the giving of notices for the purposes of these rules is that a notice takes effect when it reaches the addressee. See article . This normal rule applies only "unless otherwise provided". The present Article provides otherwise for one special

situation. Where a creditor gives notice to a debtor because the debtor is in default, or because it appears that a default is likely it seems appropriate to put the risk of loss, mistake or delay in the transmission of the message on the defaulting debtor rather than on the creditor. The dispatch principle thus applies to notices given under the following articles:

III.-2:111	Property not accepted
III.-2:112	Money not accepted
III.-3:302	Non-monetary obligations
III.-3:503	Termination after notice fixing additional time for performance
III.-3:505	Termination for inadequate assurance of performance.

The dispatch rule does not apply to a notice which is to be given by the defaulting debtor, e.g. under III.-3:104 (Excuse due to an impediment), or by a debtor who wishes to invoke hardship under III.-1:110 (Variation or termination by court on a change of circumstances), or who gives an assurance of performance under III.-3:505 (Termination for inadequate assurance of performance).

The dispatch principle for notices of this kind is not recognised in all systems but it seems a fair allocation of the risk that the notice will be delayed or lost in the course of transmission.

B. Means of notice given on default must be appropriate

The dispatch principle will not apply if the means of notice was not appropriate in the circumstances. For instance, for the dispatch principle to apply, the means chosen must be fast enough. If great speed is needed a letter sent by air mail may not be appropriate and the sender may not rely on the fact that it was dispatched. The sender will be able to rely on it only if and when it arrives.

C. Time at which notice takes effect

A notice subject to the general "receipt" principle takes effect when it is received. A notice subject to the dispatch principle may be effective even though it never arrives or is delayed, but it is not effective from the moment it is dispatched. It would not be fair that even a non-performing debtor should be affected by a notice as from that time. Accordingly the notice takes effect only from the time at which it would normally have been received.

III.-3:107: Failure to notify non-conformity

(1) If, in the case of an obligation to supply goods or services, the debtor supplies goods or services which are not in conformity with the terms regulating the obligation, the creditor may not rely on the lack of conformity unless the creditor gives notice to the debtor within a reasonable time specifying the nature of the lack of conformity.

(2) The reasonable time runs from the time when the goods are supplied or the service is completed or from the time, if it is later, when the creditor discovered or could reasonably be expected to have discovered the non-conformity.

(3) The debtor is not entitled to rely on paragraph (1) if the failure relates to facts which the debtor knew or could reasonably be expected to have known and which the debtor did not disclose to the creditor.

(4) This Article does not apply where the creditor is a consumer.

COMMENTS

A. General

The starting point for a consideration of this Article is that there is a general duty to exercise remedies in accordance with good faith and fair dealing. In certain cases that would mean that a person supplied with goods or services which did not conform to the contract would be prevented from relying on the non-conformity because of that person's conduct – for example, by sitting on the remedies for an excessive length of time knowing that the supplier was suffering prejudice by the delay. Similarly, a person who withheld performance or reduced the price without saying why would hardly be acting in accordance with good faith and fair dealing. However, a mere delay in notification of a non-conformity would not always fall under the provision on good faith and fair dealing. This Article is therefore designed to concretise the requirement to act in accordance with good faith and fair dealing in this situation. One rationale for the requirement of notification is that the supplier should be given an opportunity to put things right.

The reason for limiting the requirement to non-conforming goods or services and not any non-performance is that it is only in relation to defects that notification becomes important. The debtor who has not performed at all knows the position and does not need to be notified and the creditor should not lose any remedies by not notifying. This applies also to an obligation not to do something or to cease doing something. It is safer to confine the requirement to non-conforming goods or services.

Not all the laws of the Member States recognise this rule in full, though most will in some circumstances prevent a party who has delayed in telling the other party about the defect from exercising some remedy, particularly remedies that involve rejection of non-conforming goods. The Article, which applies only to non-consumer contracts for goods and services, mirrors the broader approach found in the CISG.

B. Requirement of notification

Paragraph (1) lays down the requirement that the supplier be notified within a reasonable time, if the person supplied is to be able to rely on the non-conformity. This is a simple requirement, not a duty or an obligation. The supplier cannot recover damages for failure to notify. That would go far too far: the person supplied with the goods or services may not be troubled by a particular non-conformity and may not wish to pursue the matter. In

such a case there is no reason why that person should be under any duty or obligation to notify. The only effect of a failure to notify is that the person supplied loses the right to rely on the non-conformity. This is of particular importance in relation to damages, price reduction and withholding performance. There are already requirements of giving notice within a reasonable time in the case of the remedies of specific performance or termination of the contractual relationship. So the Article is of less importance in relation to those remedies.

The notice must specify the nature of the non-conformity. What is sufficient specification will depend on the circumstances but the provision must be interpreted in the light of its purpose, which is largely to give the supplier a fair opportunity to cure the non-conformity. The relevant circumstances would include the buyer's knowledge and expertise. A buyer or client who is not an expert cannot be expected to diagnose a problem but can be expected to describe what seems to be wrong.

C. When time begins to run

Paragraph (2) provides that the period for notification begins to run from the time when the goods are supplied or the service is completed or from the time, if it is later, when the creditor discovered or could reasonably be expected to have discovered the non-conformity. The situation where the creditor in the obligation becomes aware during the period for its performance that there is or will be a non-conformity is dealt with by other provisions in later Books. The present provision is designed to deal with the situation where goods have been delivered or a lease period has ended or a service has been completed. So the period runs at earliest from that time. However, it will not begin to run until the person supplied has discovered or could reasonably be expected to have discovered the non-conformity. The second part of this formula ("could reasonably be expected to have discovered") is necessary to maintain a fair balance between the parties. Without it, it would be all too easy in many cases for the creditor to deny knowledge. However, it is a flexible formula which enables all relevant circumstances to be taken into account.

D. Defects known to supplier

Paragraph (3) provides an exception for those cases where the failure to notify relates to facts which the debtor knew or could reasonably be expected to have known and which the debtor did not disclose to the creditor. This is consistent with the idea of good faith and fair dealing which underlies the Article. A supplier who has knowingly concealed defects should not be able to insist on being notified of them.

E. Consumer exception

Paragraph (4) exempts consumers from the requirement to notify. The rationale is that lay people may be unaware of such a legal requirement and that it could be harsh to deprive them of remedies for failure to observe it. This does not mean, however, that consumers are not subject to any requirements to notify and can sit on remedies indefinitely regardless of the circumstances. Any person, consumer or not, who wishes to exercise the remedy of specific performance must give notice within a reasonable time. The same

applies to the remedy of termination of the contractual relationship for fundamental non-performance. These remedies can place the creditor in a particularly difficult position and fairness between the parties requires a general requirement of notice within a reasonable time. Further, as noted above, any person exercising a remedy for non-performance of an obligation is bound to exercise it in accordance with good faith and fair dealing. The argument that consumers may be unaware of legal requirements does not apply here because everybody can be expected to be aware of the need to act in accordance with such basic criteria of decent behaviour. The general duty of good faith and fair dealing will, however, be less strict on consumers than the notification rules in the Article in at least two respects. First, it would normally only be actual knowledge which will trigger any duty and secondly some prejudice or likely prejudice to the supplier would normally be required. Finally, it may be noted that these rules contain a relatively short period of prescription – three years – in those cases where the creditor is aware of all relevant facts.

Section 2: Cure by debtor of non-conforming performance

III.–3:201: Scope

This Section applies where a debtor's performance does not conform to the terms regulating the obligation.

COMMENTS

A. General

The rules in this Section give the debtor a right to cure a non-conforming performance. The allowance of a reasonable opportunity to cure is consistent with the notion of good faith and fair dealing and with the desire to uphold contractual relations where possible and appropriate. However, the interests of the debtor in being given a chance to rectify matters must be balanced by due regard for the interests of the creditor. After all, it is the debtor who has been guilty of the non-performance. If there is any doubt about the fairness of allowing an attempted cure it ought to be resolved in favour of the innocent creditor.

The rules in the present Section are wider in scope than the corresponding Article in the Principles of European Contract Law (Art. 8:104) which (as in some of the Member States' laws) applied only when the tender of performance had not been accepted because it was non-conforming. In effect, the PECL rule operated only as a restriction on the right to terminate the contractual relationship. That is probably the case which is most likely to be problematic. If, for example, the contract is for the sale of goods and, since it was made, the market price for the goods has fallen, the buyer has a strong incentive to use the non-conformity as a ground on which to escape from the contract. It seems contrary to good faith for the buyer to terminate when the seller can still deliver satisfactory goods in time. However, this is not the only case in which a right to cure may be appropriate.

The PECL provision did not apply if the buyer accepted the defective goods – so, for example, the buyer could reduce the price or claim damages for the cost of repairing the goods or the reduction in their value, without first giving the seller a chance to repair or replace them. In contrast, the Directive on certain aspects of the sale of consumer goods and associated guarantees (1999/44/EC) envisaged the seller having the opportunity to repair or replace the goods before the buyer could reduce the price or have the contract rescinded. (Art 3. The Directive does not deal with damages.) When work was being done on the Books on Sales and Leases of Movables it became obvious that a broader approach, along the lines of the Directive, would be appropriate for contracts in general. There is not such a broad “right to cure” in the laws of all the Member States, but in commercial sales such a provision is often expressly agreed. The PECL Article has therefore been considerably expanded.

B. Non-conformity

The opportunity to cure arises only where there is a non-conforming performance. This means a performance which does not conform to the terms regulating the obligation. In most cases these will be the terms of a contract but the Article is not confined to contractual obligations. Similar fact situations involving defective performances could arise in relation to other obligations.

III.–3:202: Cure by debtor: general rules

(1) The debtor may make a new and conforming tender if that can be done within the time allowed for performance.

(2) If the debtor cannot make a new and conforming tender within the time allowed for performance but, promptly after being notified of the lack of conformity, offers to cure it within a reasonable time and at the debtor’s own expense, the creditor may not pursue any remedy for non-performance, other than withholding performance, before allowing the debtor a reasonable period in which to attempt to cure the non-conformity.

(3) Paragraph (2) is subject to the provisions of the following Article.

COMMENTS

A. Still time for conforming performance

There will be many cases where the debtor has performed well within a period of time allowed for performance and where there is still time to make a conforming performance within the period. In this situation paragraph (1) provides that the debtor may make a new and conforming tender within the time allowed.

Illustration

In May S, a commodity dealer, contracts to sell a quantity of cocoa to B and to deliver this by 1st September. In mid-July S delivers the cocoa to B but upon arrival the cocoa is lawfully rejected by B as not in accordance with the contract description. S has until 1st September to deliver a fresh quantity of cocoa which conforms with the terms of the contract.

B. Conforming performance would be later than provided for

In this situation, the debtor may still make a prompt offer to cure the defective performance and the creditor cannot pursue any remedy other than withholding performance of reciprocal obligations until the debtor has had a reasonable chance to attempt a cure. This is the general rule provided for by paragraph (2). At first sight it seems very favourable to the debtor. However, this rule is heavily qualified by the restrictions in the next Article.

C. Notification of non-conformity

The debtor must make the offer to cure promptly after being notified of the lack of conformity. There is no separate requirement of notification but it is an essential element in all remedies except withholding performance. In practice a creditor would usually have an interest in giving prior informal notice of non-conformity in any event before taking steps to exercise legal remedies. In many cases the giving of notice could be regarded as required by the duty to exercise remedies in accordance with good faith and fair dealing.

III.-3:203: When creditor need not allow debtor an opportunity to cure

The creditor need not, under paragraph (2) of the preceding Article, allow the debtor a period in which to attempt cure if:

- (a) failure to perform a contractual obligation within the time allowed for performance amounts to a fundamental non-performance as defined in III. 3:502 (2);*
- (b) the creditor has reason to believe that the debtor's performance was made with knowledge of the non-conformity and was not in accordance with good faith and fair dealing;*
- (c) the creditor has reason to believe that the debtor will be unable to effect the cure within a reasonable time and without significant inconvenience to the creditor or other prejudice to the creditor's legitimate interests; or*
- (d) cure would be inappropriate in the circumstances.*

COMMENTS

A. General

This Article protects the reasonable interests of the creditor by placing some essential restrictions on the debtor's right to be allowed an opportunity to cure a non-conformity.

B. No chance to cure if performance late and the delay is a fundamental non-performance

The first essential restriction is, in the case of a contractual obligation, that the debtor has no opportunity to cure if performance is late and the delay is a fundamental non-performance. This is laid down by sub-paragraph (a) when read with paragraph (2) of the preceding Article. If the delay does not amount to a fundamental non-performance then the debtor may still attempt a cure if no other restrictions apply.

Illustration 1

In May S, a commodity dealer, contracts to sell a quantity of cocoa to B and to deliver this by 1st September. It is not delivered until 2nd September, on which date B rejects it. Assuming (as is usually the case upon a commercial sale of a commodity of this nature) that any delay in delivery will amount to a fundamental non-performance, it is too late for S to make a new and conforming tender.

Illustration 2

A agrees to build a house for B by 1 March. By 1 March some important items of work remain incomplete. Since a minor delay of this type would not normally be a fundamental non-performance of a building contract, A may complete the work at any time before the delay has become a fundamental non-performance, e.g. through the giving and expiry of a notice allowing extra time for performance.

C. Debtor in bad faith

Paragraph (b) contains an important rule. If the creditor has reason to believe that the debtor knew of the non-conformity and was not acting in accordance with good faith and fair dealing in making the defective performance, then the creditor need not offer an opportunity to cure. This is important because one of the dangers of a cure regime is that it could encourage debtors to take chances with defective performances knowing that if they were noticed there would still be an opportunity to cure. The principle of good faith and fair dealing which lies behind the provisions in this Article does not require any favours to be given to opportunistic debtors who themselves are acting in bad faith.

D. Further protection of creditor's interests

Paragraph (c) protects the creditor's interests in a more general way by providing that an opportunity to cure need not be made available if the creditor has reason to believe that the debtor will be unable to effect the cure within a reasonable time and without significant inconvenience to the creditor or other prejudice to the creditor's legitimate interests. Paragraph (d) adds that an opportunity to cure need not be offered if cure would otherwise be inappropriate in the circumstances. This is a sweeping up provision designed to catch situations which cannot be foreseen and which might not fall under any of the preceding paragraphs. It is justified by the policy of erring on the side of protecting the innocent creditor rather than the defaulting debtor.

III.–3:204: Consequences of allowing debtor opportunity to cure

(1) During the period allowed for cure the creditor may withhold performance of the creditor's reciprocal obligations, but may not resort to any other remedy.

(2) If the debtor fails to effect cure within the time allowed, the creditor may resort to any available remedy.

(3) Notwithstanding cure, the creditor retains the right to damages for any loss caused by the debtor's initial or subsequent non-performance or by the process of effecting cure.

COMMENTS

A. Consequences of allowing opportunity for cure

The consequence for the creditor of allowing the debtor an opportunity to cure is that during the period allowed for cure the creditor may withhold performance of reciprocal obligations but may not resort to any other remedy. In particular, the creditor may not terminate for fundamental non-performance. If the debtor fails to effect cure within the time allowed, the creditor may resort to any available remedy.

Paragraph (3) makes it clear that even if the debtor does cure the non-conformity within the time allowed, the creditor retains the right to damages for any loss caused by the debtor's initial or subsequent non-performance or by the process of effecting cure. This could include compensation for any inconvenience caused or any consequential loss caused by the temporary non-availability of what is being cured.

Section 3: Right to enforce performance

III.–3:301: Monetary obligations

(1) The creditor is entitled to recover money payment of which is due.

(2) Where the creditor has not yet performed the reciprocal obligation for which payment will be due and it is clear that the debtor in the monetary obligation will be unwilling to receive performance, the creditor may nonetheless proceed with performance and may recover payment unless:

(a) the creditor could have made a reasonable substitute transaction without significant effort or expense; or

(b) performance would be unreasonable in the circumstances.

COMMENTS

A. The principle

As a rule it is always possible to enforce monetary obligations. The procedural mechanisms are for national laws but the assumption is that a suitable procedure will be available.

This is the basis of the rule in paragraph (1). A monetary obligation for the purposes of this rule is every obligation to make a payment of money, regardless of the form of payment or the currency. This includes even a secondary obligation, such as the payment of interest or of a fixed sum of money as damages. But in each case, the monetary obligation must be due before it can be enforced.

The first paragraph of this Article represents the general position in all the legal systems. The restriction in the second paragraph is less commonly found. It is derived from the experience of a number of legal systems which have confronted the problem addressed by the paragraph. In some other systems similar results have been obtained by application of the principle of good faith. It seems better to have a clear provision on the issue.

B. Money not yet due

The principle that monetary obligations always can be enforced is not quite so certain where the monetary obligation has not yet been earned by the creditor's own performance and it is clear that the debtor will refuse to receive the creditor's future performance. This is the situation regulated by paragraph (2).

Basic approach. The basic approach underlying the rules of paragraph (2) is obvious. Obligations are generally binding according to their terms. The creditor is normally entitled to perform and thereby to earn the price. The debtor's unwillingness to receive the creditor's performance is therefore, as a rule, irrelevant.

However, according to sub-paragraphs (a) and (b) there are two situations where the above principle does not apply.

Cover transaction. A creditor who can make a reasonable cover transaction without significant trouble or expense is not entitled to continue with performance against the debtor's wishes and cannot demand payment of the price for it (paragraph (2) sub-paragraph (a)). The creditor should terminate the contractual relationship and either make a cover transaction, thus becoming entitled to the difference between the cover price and the contract price, or simply claim damages without making any cover transaction. The debtor cannot invoke paragraph (2)(a) unless two conditions are satisfied. The first is that the creditor can make a cover transaction on reasonable terms because there is a market for the performance or some other way of arranging a substitute transaction. The second

is that the cover transaction does not substantially burden the creditor with effort or expense.

Illustration 1

A sells 10,000 ball bearings to company B for €50,000,- payment to be made in advance. If B indicates that it will not accept delivery, A cannot force the ball bearings on B (e.g. by simply leaving them in B's yard) and sue for the price if there is a ready market for ball bearings or if A can easily find a new customer. In contrast, if A would have to make considerable efforts in finding a new customer and would have to shoulder the costs of transportation to another continent, A would not be obliged to make a cover transaction. A could sue for the price under the contract and, if B maintains its refusal to accept the goods, could deposit the goods with a third party to be held to B's order.

In certain situations the creditor may even be bound by commercial usage to effect a cover transaction. Whenever the creditor makes, or would have been obliged to make, a cover transaction, the creditor may claim from the debtor the difference between the contract price and the cover price as damages.

Unreasonable performance. A very different situation is dealt with in paragraph 2(b): Here performance by the creditor would be unreasonable. A typical example is where, before performance has begun, the debtor makes it clear that performance is no longer wanted. This situation can arise, for example, in construction contracts, other contracts for work and especially long term contracts.

Illustration 2

H has hired for a period of three years advertising space on litter bins supplied to local councils by C. Before commencement of that period and before preparation of the advertisement plates by C, H purports to cancel the contract. Even though paragraph 2(a) does not apply because there is abundance of advertising space available, C may not proceed to perform the contract and then claim the hire charges, for it is unreasonable to undertake performance of a contract in which C no longer has an interest.

The non-performance may be actual (i.e. the date for performance has passed) or anticipated.

An instance where performance might be reasonable is where the creditor has an interest in performing in order to occupy and train a workforce which must be kept on.

Common features. The feature common to the two cases dealt with in paragraph (2) is that the debtor is at risk of being forced to accept a performance which is no longer wanted.

However, neither of the two exceptions laid down in paragraph (2) affects the right of a beneficiary under a letter of credit to claim payment from the bank. This is because letters of credit are treated as independent of the underlying contract.

Legal consequences of exceptions. One of the consequences that arise if either one of the exceptions applies, is spelt out in paragraph (2): the creditor may not demand the money owed under the contract for the counterperformance, in particular the price. However, damages for non-performance may be claimed.

III.–3:302: Non-monetary obligations

(1) The creditor is entitled to enforce specific performance of an obligation other than one to pay money.

(2) Specific performance includes the remedying free of charge of a performance which is not in conformity with the terms regulating the obligation.

(3) Specific performance cannot, however, be enforced where:

(a) performance would be unlawful or impossible;

(b) performance would be unreasonably burdensome or expensive; or

(c) performance would be of such a personal character that it would be unreasonable to enforce it.

(4) The creditor loses the right to enforce specific performance if performance is not requested within a reasonable time after the creditor has become, or could reasonably be expected to have become, aware of the non-performance.

(5) The creditor cannot recover damages for loss or a stipulated payment for non-performance to the extent that the creditor has increased the loss or the amount of the payment by insisting unreasonably on specific performance in circumstances where the creditor could have made a reasonable substitute transaction without significant effort or expense.

COMMENTS

A. General

This Article allows the creditor to enforce specific performance of a non-monetary obligation by the debtor. The creditor has not only a substantive right to the debtor's performance but also a remedy to enforce this right specifically, e.g. by applying for an order or decision of a court. Again the procedural mechanisms available for the enforcement of specific performance are for national laws, as are the sanctions for non-compliance with any judgment ordering specific performance.

The Article covers all non-monetary obligations - e.g. to do or not to do an act, to make a declaration or to deliver something. It covers an obligation to accept performance. In some cases a court order itself will act as a substitute for performance by the debtor.

Illustration 1

A who had first rented his immovable to B and later on agreed to sell it to him, refuses to transfer ownership to B. Unless paragraph (2) applies, B is entitled to a court order directing A to transfer ownership to B or, in some countries, a court order which itself takes the place of a document of transfer executed by A.

The right to enforce specific performance of a non-monetary obligation applies not only where no performance at all is tendered by the debtor but also where the debtor has attempted to perform but the attempt does not conform to the terms regulating the obligation. This is made clear by paragraph (2).

However, the right to enforce specific performance is subject to the exceptions in paragraph (3) and to the time limit in paragraph (4).

B. The principle and exceptions

Whether a creditor should be entitled to enforce specific performance of a non-monetary obligation is controversial. In England and Ireland specific performance is regarded as an exceptional remedy but in other European countries, including Scotland, it is regarded as an ordinary remedy. There is reason to believe, however, that results in practice are rather similar under both theories. The Article takes a pragmatic approach. A right to enforce specific performance is admitted in general (paragraphs (1) and (2)) but excluded in several special situations (paragraphs (3) and (4)). Paragraph (5) also operates indirectly as a restriction in cases in which the creditor could have avoided losses by making a substitute transaction instead of insisting upon enforcing specific performance.

A general right to enforce specific performance has several advantages. Firstly, through specific relief the creditor obtains as far as possible what is due; secondly, difficulties in assessing damages are avoided; thirdly, the binding force of obligations is stressed. A right to enforce specific performance is particularly useful in cases of unique objects and in times of scarcity.

On the other hand, comparative research of the laws and especially commercial practices demonstrate that the principle of allowing the enforcement of specific performance must be limited. The limitations are variously based upon natural, legal and commercial considerations and are set out in paragraphs (3) and (4). In all these cases other remedies, especially damages and in appropriate cases termination, may be adequate remedies for the creditor.

C. Right to require remedying of defective performance

If the debtor attempts to perform, but the attempted performance does not conform to the terms regulating the obligation, the creditor may choose to insist upon a conforming performance. This may be advantageous for both parties. The creditor obtains what is due and the debtor obtains a discharge (and any price or other counter-performance which is due) and preserves a reputation as a person who fulfils obligations.

A conforming performance may be achieved in a variety of ways: for example, repair; delivery of missing parts; or delivery of a replacement.

The right to enforce a conforming performance is, of course, subject to the same exceptions as the general right to enforce performance (see Comments D-J). Thus a debtor cannot be forced by court order to accomplish a performance conforming to the contract if this would be unduly burdensome or expensive or if the creditor has failed to demand performance within a reasonable time.

D. Exceptions, but no judicial discretion

Under the Article the creditor has a right to enforce performance of a non-monetary obligation. Granting an order for performance thus is not in the discretion of the court; the court is bound to grant the remedy, unless the exceptions of paragraphs (3) or (4) apply.

E. Impossibility and illegality

For obvious reasons, there is no right to enforce performance if it is impossible (paragraph (3)(a)). This is particularly true in case of factual impossibility, i.e. if some act in fact cannot be done. The same is true if an act is prohibited by law. Similarly, specific performance is not available where a third person has acquired priority over the creditor to the subject matter of the obligation.

If an impossibility is only temporary, enforcement of performance is excluded during that time.

Whether or not the impossibility makes the debtor liable in damages is irrelevant in this context.

F. Performance unreasonably burdensome or expensive

Performance cannot be required if it would be unreasonably burdensome or expensive for the debtor (paragraph (3)(b)). Burdensome does not mean financially burdensome. It is wider than that. It could cover something which involved a disproportionate effort or even something which was liable to cause great distress, vexation or inconvenience. No precise rule can be stated on when a performance would be “unreasonably” burdensome or expensive. However, considerations as to the reasonableness of the transaction or of the appropriateness of the counter-performance are irrelevant in this context. Nor is

paragraph (3)(b) limited to the kind of supervening event cases covered by III.-1:110 ((Variation or termination by court on a change of circumstances) .

Illustration 2

A, who has sold his yacht "Eliza" to B, promised to deliver it at B's domicile. On the way "Eliza" is hit by a ship and is sunk in 200 metres of water. The costs of raising her would amount to forty times her value. The cost of forcing A to perform would be unreasonable.

Performance may have become useless for the creditor. In such cases it may then be vexatious and unreasonably burdensome to force the debtor to perform.

Illustration 3

A leased his farm for five years to mining company B for strip mining. In addition to paying rent, B promised to restore the land after completing the mining operation. In the meantime, A decides to lease the land after its return from B to the army for use as a training area for tank crews. If B would have to spend a large amount of money in order to restore the land and its value would thereby increase by only marginally, the restoration would be unreasonably burdensome.

In deciding whether performance would be unreasonably burdensome or expensive it may be relevant to take into account whether the creditor could easily obtain performance from another source and claim the cost of doing so from the debtor.

Illustration 4

Company A sells and delivers to company B a piece of machinery. On delivery B discovers that an adjustment of the machinery is defective. The defect can easily be cured by a competent engineer. A has no engineers within 300 km of B's place of business. It would cause A unreasonable expense to send one of its own engineers to do something which could be done locally. A offers to pay for the adjustment to be done by a local engineer. If B can easily get a local firm to do the adjustment B cannot require A to do it.

G. Performance would be of such a personal character that it would be unreasonable to enforce it

Paragraph (3)(c) is based partly on considerations of practicality. It might be pointless to try to enforce specific performance of certain obligations of a highly personal character. Mainly, however, it is based on respect for the debtor's human rights. The debtor should not be forced to perform if the performance consists in the provision or acceptance of services or work which is of such a personal character or is so dependent upon a personal relationship that enforcement would infringe the debtor's human rights. The criterion here is not simply the personal nature of the work or services to be provided. To exclude enforcement of specific performance of all obligations to provide work or services of a personal character would be far too broad. The criterion is whether enforcing performance would be unreasonable. In deciding that question regard would have to be

had to the debtor's human rights and fundamental freedoms, including in particular the rights to liberty and bodily integrity. For example, an obligation to take part in a medical experiment involving surgical procedures on the debtor would not be specifically enforced. There is no reason, however, why a firm of professional carers should not be forced to perform their contracts to supply personal caring services. And there is no reason why many ordinary employment contracts should not be enforced, although certain employment contracts requiring work or services of a highly personal nature from the debtor's point of view, or the continuance of a highly personal relationship, might be caught by this sub-paragraph. The position is similar in relation to partnership contracts or contracts to form a company. Some might involve such a close personal relationship that the exception would apply. Others might not.

Illustration 5

The six heirs of a factory-owner conclude a contract in due form to establish a limited company in order to continue the inherited business. Later A, one of the heirs, who was not to assume any management functions in the company, refuses to co-operate in the creation of the company. The other heirs may enforce performance of A's obligation under the agreement. The result might be different if the agreement were one to create a partnership in which all the partners were to play an active role.

The expression "of a personal character" does not cover services or work which may be delegated. However, a provision in a contract that work may not be delegated does not necessarily make the work of a personal character. If the contract does not need the personal attention of the contracting party but could be performed by employees, the term prohibiting delegation may be interpreted as preventing only delegation to another enterprise, e.g. a sub-contractor. The signing of a document would not usually constitute performance of a personal character. An obligation to sign a document can mostly be enforced since the debtor's act can often be replaced by a court decree (See Comment A).

The reason for the exception in paragraph (3)(c) is not that the work or services, if forced, might not be satisfactory for the creditor. That is a question for the creditor to decide, not a reason for a sweeping automatic exception. A creditor who has doubts about the value of enforced performance does not need to seek an order for specific performance. It would be for the creditor to decide, for example, whether it would be advisable to seek an order to enforce specific performance by an artist of an obligation to paint a portrait. There might be situations (e.g. portrait almost finished apart from some routine background work; completion and signature by the artist would greatly increase the value) where the creditor might wish to enforce specific performance of such an obligation and where it would be entirely reasonable to do so. There might be other situations where the creditor might consider that enforced performance would result in a ghastly portrait. It is for the creditor to decide.

H. Reasonable certainty

There is another restriction on the availability of a court order enforcing specific performance, under the sanction of imprisonment or a fine, which stems from human rights requirements and therefore does not need to be set out in the Article. The court order would have to make it reasonably clear what the debtor was required to do in order to comply. It would be unacceptable to imprison or fine someone for disobeying a court order if the order did not make it clear what had to be done.

I. Reasonable time

A request for performance of a non-monetary obligation must be made within a reasonable time (paragraph (4)). This provision is supplementary to the normal rules on notification of non-conformity and on prescription and is intended to protect the debtor from hardship that could arise in consequence of a delayed request for performance by the creditor. Where the creditor is a consumer, the creditor's interests are not seriously affected by this limitation because other remedies are still available. (See III.-3:107 (Failure to notify non-conformity))

The length of the reasonable period of time is to be determined in view of the rule's purpose. In certain cases, it may be very short, e.g. if delivery can be made out of the debtor's stock in trade. In other cases it may be longer. The rules on prescription in Chapter 7 will come into operation if there is a sufficiently long delay.

It is the debtor who will have to show that the delay in requesting performance was unreasonably long.

J. Limitations on abuse of remedy

There could be a danger that a creditor, by insisting unreasonably on specific performance by the debtor when the creditor could easily obtain performance elsewhere, could inflate the damages payable for non-performance by the debtor or the amount of a stipulated payment for non-performance which is calculated by the day or week. One control on such abuse is the general provision that remedies must be exercised in accordance with good faith and fair dealing. Another, more specific, control is provided by paragraph (5) which prevents the creditor from recovering damages or a stipulated amount for non-performance to the extent that the creditor has increased the loss or the amount of the payment by insisting unreasonably on specific performance in circumstances where the creditor could reasonably be expected to obtain performance from another source.

III.-3:303: Damages not precluded

The fact that a right to enforce specific performance is excluded under the preceding Article does not preclude a claim for damages.

COMMENTS

A. The basic situation

This Article makes it clear that even in those exceptional cases where specific performance cannot be enforced the creditor may still recover damages, if they are otherwise available. Damages are always available if the non-performance has caused the creditor to suffer loss, unless the non-performance is excused.

B. Other consequences

The provision does not deal with the question whether in the cases in which a claim to performance of a contractual obligation is excluded the creditor may terminate the contractual relationship in whole or in part. This will depend on the application of other Articles. In some cases it might be possible to imply an agreement between the parties to terminate their mutual obligations. For example, if the creditor accepts that it would be unreasonably burdensome for the debtor to perform and obtains performance elsewhere with the debtor's express or implied assent, it may be possible to imply an agreement between the parties that their obligations to provide and pay for that particular performance are at an end.

Section 4: Withholding performance

III.-3:401: Right to withhold performance of reciprocal obligation

(1) A creditor who is to perform a reciprocal obligation at the same time as, or after, the debtor performs has a right to withhold performance of the reciprocal obligation until the debtor has tendered performance or has performed.

(2) A creditor who is to perform a reciprocal obligation before the debtor performs and who reasonably believes that there will be non-performance by the debtor when the debtor's performance becomes due may withhold performance of the reciprocal obligation for as long as the reasonable belief continues. However, the right to withhold performance is lost if the debtor gives an adequate assurance of due performance.

(3) A creditor who withholds performance in the situation mentioned in paragraph (2) has a duty to give notice of that fact to the debtor as soon as is reasonably practicable and is liable for any loss caused to the debtor by a breach of that duty.

(4) The performance which may be withheld under this Article is the whole or part of the performance as may be reasonable in the circumstances.

COMMENTS

A. General

Although this Article applies to all reciprocal obligations (provided they are within the intended scope of these rules) it will find its main application in relation to contractual obligations. Where under a synallagmatic contract (that is, one in which both parties have obligations) one party is to perform first but has not yet done so, or is to perform simultaneously with the other but is not able or willing to do so, it is both just and commercially convenient for the other party to have the right to withhold or suspend the counter-performance. This both protects the withholding party from having to advance credit to the non-performer and gives the latter an incentive to perform in order to receive the counter-performance. The well-known *exceptio non adimpleti contractus* is an expression of this idea. Performance of one obligation may be withheld so long as the other is not fully performed.

Illustration 1

A employs B to build a house for him; the contract provides that within two days of the contract being signed, A will make an advance payment to B. B need not start work until the payment has been made.

A party whose own conduct causes the other party's non-performance may not invoke this Article to withhold performance. See III.-3:101 (Remedies available) paragraph (3).

Illustration 2

The owner of a house enters a contract with a municipal organisation for communal steam heating. The account is to be sent out by the 15th of one month and to be paid by the 15th of the next month. Because of a computer breakdown the organisation does not send out the account for 15 January until 10 February, and the house-owner has not paid by 15 February. The municipality cannot suspend the supply of steam.

B. Non-performance need not be fundamental

A party's non-performance need not be fundamental in order to entitle the other party to withhold performance. This is balanced, however, by a reasonableness requirement and by other provisions for the protection of the debtor. The Article on good faith and fair dealing must also be kept in mind.

C. Reasonableness

Paragraph (4) introduces a reasonableness requirement which applies to the whole Article. The performance which may be withheld under the Article is the whole or part of the performance as may be reasonable in the circumstances.

Illustration 3

A agrees to buy a new car from B, a dealer. When A comes to collect the car there is a scratch on the bodywork. A may refuse to accept the car or pay any part of the price until the car is repaired.

Illustration 4

The same except that the car is to be shipped to A's home in another country, where B has no facilities. Since it would be unrealistic to expect B to repair the scratch, it would be unreasonable and contrary to good faith for A to withhold more than the cost of having the car repaired locally.

In some cases the creditor cannot practicably withhold performance in part - for instance, many obligations to perform a service must realistically be performed in full or suspended in full. The creditor may only withhold performance in full if in the circumstances that is not unreasonable. However, it may be expressly provided in a contract that a performance is made reciprocal to the other performance.

The restriction in this paragraph is not found in the laws of all the Member States, at least in such a clear form, but it seems only consistent with the general duty of good faith and fair dealing.

D. Party who is to perform at same time or after the other

Paragraph (1) provides that a creditor who is to perform a reciprocal obligation simultaneously with or after the debtor performs has a right to withhold performance of the reciprocal obligation until the debtor has tendered performance or has performed. This will be the normal case for a withholding of performance.

E. Party who is to perform first

It is obvious that a party who is obliged to tender performance first is not entitled to withhold performance merely because the other is not willing to perform at that stage.

Illustration 5

A contracts with B to have a wall built in A's garden for a fixed sum payable on completion. B cannot require an advance payment as a condition of starting work.

However, paragraph (2) provides for the remedy of withholding performance to be available in certain cases of anticipated non-performance. It is available if the creditor reasonably believes that there will be non-performance by the debtor when the debtor's performance becomes due. The creditor may withhold performance of the reciprocal obligation for as long as the reasonable belief continues. An unqualified right to withhold performance in such situations could be open to abuse. However the debtor is protected in two ways. First, if the creditor's belief is not reasonable – an objective test – the creditor will be liable for non-performance. Secondly, the right to withhold performance is lost if the debtor gives an adequate assurance of due performance. So as to enable the

debtor to clarify the situation (and thereby perhaps destroy the reasonableness of the creditor's belief) or make an adequate assurance of due performance, the Article provides in paragraph (3) that the creditor has a duty to give notice of the withholding to the debtor as soon as is reasonably practicable. This is not a requirement for withholding performance. That would be unrealistic in some cases. But the creditor will be liable for any loss caused to the debtor by a breach of the duty.

Illustration 6

In January B agrees to build a house for O and to start work on 1st May. O undertakes to make an advance payment as part of the price by not later than 1st June, time of payment being regarded as fundamental. During May O tells B that because of recent heavy expenditure it will not be possible to pay the advance payment until the beginning of July. Instead of terminating for non-performance, B may keep the obligations in being for performance by O and may meanwhile suspend the building works. B must notify O that this is being done so that O has a chance to raise the money or provide security for payment.

Section 5: Termination

III.-3:501: Scope and definition

(1) This Section applies only to contractual obligations and contractual relationships.

(2) In this Section "termination" means the termination of the contractual relationship in whole or in part and "terminate" has a corresponding meaning.

COMMENTS

A. Termination as a remedy

This Section appears in a Chapter headed "Remedies for non-performance". It follows that it is dealing only with termination as a remedy for non-performance of an obligation or, in a few cases, for something (such as a failure to give an adequate assurance of performance) which is treated as the equivalent of non-performance.

B. Contractual obligations

Unlike most of this Chapter, the present Section applies only to contractual obligations and contractual relationships. There are two reasons for this. First, it will be extremely unusual for the remedy of termination to be useful in relation to non-contractual obligations. The main usefulness of termination is that it frees the creditor to obtain goods or services elsewhere and, in certain situations, to recover what has been paid or provided already under the contract. In the case of reciprocal non-contractual obligations other available remedies - withholding performance, enforcing specific performance,

damages and interest - should be adequate. Secondly, it could be regarded as inappropriate to allow private citizens to terminate by notice obligations arising by operation of law.

C. Meaning of “termination”

There is great variation between, and sometimes even within, legal systems in the terminology used for the remedy provided by this Section. These rules opt for the neutral “termination” instead of any technical term such as “rescission”. It is hoped that this may help to avoid the translation problems which are inherent in the use of technical terms and may help to make it clear that the general effect of the remedy is prospective, not retrospective.

The use of the word “termination” immediately raises the question of what is terminated.

The Principles of European Contract Law talk of “termination of the contract”. However, in the context of these rules the expression “termination of the contract” is not strictly accurate. It is not the contract as defined in these rules (i.e. an agreement of a certain kind; a type of juridical act) which is terminated. The juridical act took place. It was done and cannot be terminated. It would be more accurate to say that it is the contractual relationship between the parties which is terminated. However, the relationship is not necessarily terminated completely. There may be cases where, for example, only a separable part of the parties’ obligations and rights under the contract is terminated. In such cases the relationship may continue: it is modified rather than terminated. Even in other cases aspects of the relationship (e.g. relating to arbitration, or payment of a fixed sum by way of compensation for losses, or the return of property) may survive. This is why the Article refers to termination of the contractual relationship in whole or in part.

D. Grounds for termination in general

The grounds for termination under this Section are essentially of two types. First there is fundamental non-performance by the debtor, regulated by III.–3:502 (Termination for fundamental non-performance) . And secondly there are what might be called equivalents to non-performance, regulated by the succeeding three Articles. These are:

- (a) where the creditor has allowed the debtor a further time to perform but the debtor has not performed within that time (III.–3:503)
- (b) where there is an anticipated fundamental non-performance (III.–3:504); and
- (c) where the debtor has failed to give an adequate assurance of performance when called upon to do so (III.–3:505).

Termination under this Section may be effected by the act of the creditor alone; there is no need to bring an action in court. Termination is effective only if notice of termination is given by the creditor to the debtor. This is regulated by subsequent Articles.

If the requirements for termination are satisfied these rules do not provide for any period of grace to be granted to the debtor by a court or an arbitral tribunal.

Sub-section 1: Grounds for termination

III.-3:502: Termination for fundamental non-performance

(1) A creditor may terminate if the debtor's non-performance of a contractual obligation is fundamental.

(2) A non-performance of a contractual obligation is fundamental if:

(a) it substantially deprives the creditor of what the creditor was entitled to expect under the contract, as applied to the whole or relevant part of the performance, unless at the time of conclusion of the contract the debtor did not foresee and could not reasonably be expected to have foreseen that result; or

(b) it is intentional or reckless and gives the creditor reason to believe that the debtor's future performance cannot be relied on.

COMMENTS

A. Termination for fundamental non-performance

Whether, in the case of a non-performance of a contractual obligation, the creditor should have the right to terminate the contractual relationship in whole or in part depends upon a weighing of conflicting considerations.

On the one hand, the creditor may desire wide rights of termination. The creditor will have good reasons for terminating if the performance is so different from that due that the creditor cannot use it for its intended purpose, or if it is so late that the creditor's interest in it is lost. In some situations termination will be the only remedy which will properly safeguard a creditor's interests, for instance when the debtor is insolvent and cannot perform the obligation or pay damages. The creditor may also wish to be able to terminate in less serious cases. A creditor who fears that the debtor may not perform may wish to be able to take advantage of the threat of termination to ensure that the debtor performs in complete compliance with the terms regulating the obligation. A creditor may also wish to terminate for less appropriate reasons. The creditor may, for example, hope to escape from a contract that has turned out to be unprofitable because of a change in the market price since the contract was concluded.

For the debtor, on the other hand, termination usually involves a serious detriment. In attempting to perform the debtor may have incurred expenses which are now wasted, and may lose all or most of the value of the performance when there is no market for it elsewhere. When other remedies such as damages or price reduction are available these

remedies will often safeguard the interests of the creditor sufficiently so that termination should be avoided.

For these reasons it is only a fundamental non-performance which will justify termination under this Article.

In one respect the present Article differs from both the law in some Member States and the provision in PECL which defined “fundamental non-performance”, art. 8:103. PECL 8:103(a) provided that a non-performance would also be fundamental if strict compliance with the obligation was “of the essence” of the contract. This left it open to a court to treat an obligation as “of the essence”, so that any failure to perform it would give the other party the right to terminate the contractual relationship, even if the non-performance had no serious consequences for the other party. In some situations the parties may wish certain obligations to be treated in that way, for example time provisions in commodity contracts. However it does not seem appropriate to apply the same approach as a general rule for all contracts. If the parties wish non-performance of an obligation to have that effect, they remain free to provide for it in their agreement, see Comment C; or there may be a usage to that effect in the trade concerned.

B. Meaning of fundamental non-performance

Paragraph (2)(a) provides that where the effect of non-performance is substantially to deprive the creditor of what the creditor was entitled to expect under the contract, as applied to the whole or relevant part of the performance, then in general the non-performance is fundamental. This is not the case, however, where the debtor did not foresee and could not reasonably be expected to have foreseen those consequences.

There are three elements in the definition.

First, what was the creditor entitled to expect? This depends to a large extent on the nature and terms of the contract. If the contract allows the debtor a certain latitude in performing then the creditor will not be entitled to expect conformity with some more exacting standard. If it provides for strict compliance with certain provisions then the creditor is entitled to expect such strict compliance. Usages and practices may be important in deciding what a party is entitled to expect. For example, in certain fields of activity strict adherence to the precise time of delivery, or the provision of documents in a precise form may be expected. In some cases the nature of the contract may be decisive. For example, where a contract is for the delivery of flowers for a wedding at a stated time the purchaser will be entitled to expect delivery in time for the wedding and not the next day. What the creditor is entitled to expect will also depend on the qualifications and experience of the party concerned. It is reasonable to expect more skill and knowledge from a highly paid specialist than from an unskilled, modestly paid employee.

The second question is whether the non-performance *substantially deprives* the creditor of what the creditor was entitled to expect. This will be a question of fact to be answered on the circumstances of each case.

Illustration 1

A, a contractor, promises to erect five garages and to build and pave the road leading to them for B's lorries, all the work to be finished before October 1st, when B opens its warehouse. On October 1st the garages have been erected; the road has been built but not paved, which prevents B from using the garages. B has been substantially deprived of what he was entitled to expect under the contract. A's non-performance is fundamental.

Illustration 2

The facts are as in Illustration 1 except that the unpaved road is sufficiently smooth that the garages may be used by B's lorries in spite of the fact that the road is not yet paved, and A paves the road soon after October 1st. B has not been substantially deprived of what he was entitled to expect. A's non-performance is not fundamental.

The third question is whether the debtor foresaw or could reasonably be expected to have foreseen the result.

Illustration 3

A agrees to install a temperature control system in B's wine cellar which will ensure that his fine wines are not adversely affected by substantial temperature fluctuations. Owing to a defect in the installation the control system proves ineffective, with the result that B's stock of fine wines is made undrinkable. A's non-performance is fundamental. B has been substantially deprived of what he was entitled to expect under the contract. Moreover A was aware, or could reasonably be expected to have been aware, of the likely consequences of an inadequate system.

Illustration 4

A agrees to install central heating in B's house with a temperature control system which will enable the temperature to be maintained at a constant temperature of 20 degrees centigrade. Unknown to A one room is required to develop and preserve certain rare species of plant which are extremely sensitive to changes in temperature and which have taken several years' intensive work to breed. As a result of a defect in one of the heating pipes in the room the temperature falls by two degrees centigrade and all the plants die, rendering abortive years of work. A's non-performance is not fundamental, as it could not reasonably be expected to have foreseen that such grave consequences would ensue from a slight temperature fluctuation in the room of a private house.

The reference to the relevant part of the performance in sub-paragraph (a) is important in relation to cases where the contractual obligations are to be performed in parts or are

otherwise divisible. In such cases, the effect of a later Article III.–3:506 (Scope of right when obligations divisible) is that if a separate counter-performance can be allocated to each part, the creditor will not normally be able to terminate the entire contractual relationship merely because substantially deprived of what was expected in relation to one divisible part. So, in a contract for the delivery of supplies monthly over a period of ten years a delay or non-conformity in one month's instalment may amount to a fundamental non-performance in relation to that month but not in relation to the contract as a whole.

Paragraph (2)(b) makes it clear that even where the non-performance of an obligation does not substantially deprive the creditor of what the creditor could have expected to receive the creditor may treat the non-performance as fundamental if it was intentional or reckless and gives the creditor reason to believe that the debtor's future performance cannot be relied on .

Illustration 5

A, who has contracted to sell B's goods as B's sole distributor and has undertaken not to sell goods in competition with those goods, nevertheless contracts with C to sell C's competing goods. Although A's efforts to sell C's goods are entirely unsuccessful and do not affect his sales of B's goods, B may treat A's conduct as a fundamental non-performance.

Illustration 6

P's agent, A, who is entitled to reimbursement for his expenses, submits false vouchers to P. Although the amounts claimed are insignificant P may treat A's behaviour as a fundamental non-performance and terminate his agency.

But where no future performance is due from the debtor, other than the remedying of the non-performance itself, or where there is no reason to suppose that the debtor will not properly perform future obligations under the contract, the creditor cannot invoke subparagraph (b).

Illustration 7

A contracts to build a supermarket for B. A completes performance except that, angered by a dispute over an unrelated transaction, it refuses to build a cover over a compressor. B can have the cover built by another contractor for a trifling sum. A's non-performance, even although intentional, is not fundamental.

Illustration 8

A contracts to build a supermarket for B; the specification calls for the building to be faced with an expensive type of brick. A's supervisor orders a cheaper type of brick to be used to face a wall which is not easily visible but, as soon as B points out the discrepancy, A agrees to remove the cheaper bricks and to use the proper sort in future. A's non-performance does not give B reason to believe that it cannot rely on A's performance in future.

C. Relationship to right to cure

In many contracts, a party's obligation has a double aspect: it is to do x by date y . Until y , the time for performance, has arrived the obligation is not due and there will, by definition, be no non-performance. This is why the debtor has the right to cure a non-conforming performance if this can be done before the time for performance has arrived (see III.–3:202 (Cure by debtor: general rules) paragraph (1)). The debtor should be in no worse position than if performance had not been attempted at all: if the debtor can perform properly by y , the performance will have been in accordance with the contract.

Even when the time for performance has arrived, the debtor who has tendered a performance which does not meet the requirements of the contract may still have the right to cure provided that the delay is not already fundamental (see III.–3:203 (When creditor need not allow debtor an opportunity to cure) sub-paragraph (a)). Again, the starting position is that the debtor who has tried to perform but has not done it well enough should not be in a worse position than one who had not performed at all. Had the debtor not performed at all by the time performance was due, the creditor would not necessarily be entitled to terminate immediately. Termination would be available as a remedy only if the delay was, or when it became, sufficiently serious that it deprived the creditor of the substance of what the creditor was entitled to expect (see III.–3:502 ((Termination for fundamental non-performance) paragraph (2)(a)); or after the creditor had set a reasonable time for performance under III.–3:503 (Termination after notice fixing additional time for performance) paragraph (1) and the debtor had failed to perform within that time. However, in this case allowing the debtor “a second chance” might be inconvenient to the creditor, or in some cases may be too generous to the debtor. Therefore III.–3:203 (When creditor need not allow debtor an opportunity to cure) imposes other restrictions.

It follows that the creditor's right to terminate is in effect subject to the debtor's right to cure. There is no right to cure, however, in cases that fall within paragraph (2)(b) of III.–3:502 (Termination for fundamental non-performance), since in that case the creditor has the right to terminate immediately (cf the parallel right to terminate immediately when fundamental non-performance is anticipated, see III.–3:504 (Termination for anticipated non-performance)).

D. Agreed rights to terminate not covered by this Section

The terms of the contract will, as we have seen, always be important in deciding whether or not a non-performance is fundamental under the present Article. What a party is entitled to expect depends on what the contract provides. However, the parties may wish to go beyond merely indicating what the creditor is entitled to expect. They may wish to confer an express right to terminate for any non-performance, however minor, or even for something which is not a non-performance at all. They are free to do so. Such express rights to terminate are not, however, within the present Section. They are governed by an earlier Article. (See III.–1:109 (Variation or termination by notice.)) In some cases the

parties may wish to provide not only for a right to terminate but also for the payment of compensation or extended damages or a stipulated sum for non-performance. Again they are free to do so. The effect of any such provisions will depend primarily on their terms, interpreted if need be. It is in the interest of any party who wishes to rely on such terms to ensure that their meaning and effect is clear.

III.-3:503: Termination after notice fixing additional time for performance

(1) A creditor may terminate in a case of delay in performance of a contractual obligation which is not in itself fundamental if the creditor gives a notice fixing an additional period of time of reasonable length for performance and the debtor does not perform within that period.

(2) If the period fixed is unreasonably short, the creditor may terminate only after a reasonable period from the time of the notice.

COMMENTS

A. General

The effect of this Article is that where there has been a delay in performance but the delay is not yet fundamental the creditor may terminate after having given the defaulting debtor reasonable notice. This very practical rule is now to be found in the laws of many Member States, though not always in precisely the same form or with precisely the same effects.

B. Setting a time-limit for performance in cases of non-fundamental delay

Not every delay in performance of an obligation will constitute a fundamental non-performance and so the creditor will not necessarily have the right to terminate immediately merely because the date for performance has passed. In cases of non-fundamental delay, however, the creditor can fix an additional period of time of reasonable length for performance by the debtor. If upon expiry of that period of time performance has not been made, the creditor may terminate.

Illustration 1

C employs D to build a wall in C's garden. The work is to be completed by April 1st but prompt completion is not fundamental. By that date D has not completed the work and appears to be working very slowly. Less than a week's work is necessary to complete the wall. C may give D a further week in which to complete the wall and, if D does not do so, C may terminate the contractual relationship.

The notice procedure may be useful when the non-performance is of an accessory obligation to accept or to allow performance of a primary obligation by the other party.

Illustration 2

E employs F to decorate the interior of an empty apartment owned by E but E fails to give F a key to the apartment by the date on which it was agreed that F should start work. F may give E a reasonable time in which to arrange access for F and, if E fails to do so, F may terminate.

It should be noted that this Article applies even if the non-performance is excused because of a temporary impediment.

C. When the notice must be for a definite reasonable period

When a notice fixing an additional period for performance is served after a non-fundamental delay, it will only give the creditor the right to terminate if, first, it is for a fixed period of time, and secondly, the period is a reasonable one.

If the notice is not for a fixed period of time it may give the defaulting party the impression that performance can be postponed indefinitely. It will not suffice to ask for performance "as soon as possible". It must be a request for performance, say, "within a week" or "not later than July 1". The request must not be couched in ambiguous terms; it is not sufficient to say that "we hope very much that performance can be made by July 1".

Because in cases of non-fundamental delay the notice procedure is conferring an additional right on the creditor, the period of notice must be reasonable. If the creditor serves a notice of less than a reasonable period a second notice is not needed; the creditor may terminate after a reasonable time has elapsed from the date of the notice.

D. What period of time is reasonable?

The determination of what is a reasonable period of time must ultimately be left to the court. Various factors may be important. The period of time originally set for performance may be relevant: if the period is short, the additional period of time may also be short. The need of the creditor for quick performance may be relevant, provided that this is apparent to the defaulting debtor. The nature of the goods, services or rights to be performed or conveyed may be important: a complicated performance may require a longer period of time than a simple one. The nature of the event which caused the delay may also be relevant; a party who has been prevented from performance by bad weather should be granted a longer respite than a party who merely forgot about the obligation .

E. The creditor may provide for automatic termination

If the defaulting debtor has not performed the obligation by the expiry of the period of time fixed for performance, or has before that time given notice of a refusal to perform, the creditor may then give notice of termination. However, the creditor may provide for automatic termination. The notice may, for example, say that the creditor will be free from liability if the defaulting debtor fails to perform within the period of the notice.

If the defaulting debtor in fact tenders performance after the date set in the notice, the creditor may simply refuse to accept it. However, if the creditor actually knows that the debtor is still attempting to perform after the date, good faith requires the creditor to warn the debtor that the performance will not be accepted. If the debtor asks the creditor whether performance will be accepted after the date set, good faith requires the creditor to give an answer within a reasonable time.

III.–3:504: Termination for anticipated non-performance

A creditor may terminate before performance of a contractual obligation is due if the debtor has declared that there will be a non-performance of the obligation, or it is otherwise clear that there will be such a non-performance, and if the non-performance would have been fundamental.

COMMENTS

A. Terminology

The neutral and descriptive expression “anticipated non-performance” is used here rather than the expression “anticipatory non-performance” which is the technical term of art in some legal systems and which is used in the UNIDROIT Principles (Article 7.3.3). “Anticipated” is more accurate in relation to the content of the present Article. The Article does not deal with actual non-performance of a special type, requiring a special adjective. It deals with the situation where future non-performance of a type which would justify termination is clearly anticipated.

The right of a creditor to terminate the contractual relationship in a case of anticipated fundamental non-performance is recognised in many laws. That is not so in some systems, especially those in which a contractual relationship can be terminated normally only by the decision of a court (see Comments to III.–3:507 (Notice of termination)), but at least some of these systems have used other means to reach the same, very convenient, result.

B. Anticipated non-performance equated with actual non-performance

The Article entitles the creditor to terminate if the debtor has repudiated the contract by saying that there will be no performance or if it is otherwise clear that there will be a fundamental non-performance by the debtor. There will have to be an obvious unwillingness or inability to perform where the failure in performance would be fundamental. The creditor’s right to terminate rests on the notion that the creditor cannot reasonably be expected to continue to be bound by such obligations once it has become clear that the debtor cannot or will not perform the main obligation at the due date. The main effect of the Article is that for the purpose of the remedy of termination a clearly

anticipated fundamental non-performance is equated with an actual fundamental non-performance after performance has become due.

Illustration 1

In January a construction company agrees to build a house for O and to start work on 1st May. In April the company tells O that owing to labour troubles it will not be able to carry out the contract. O may immediately terminate the whole contractual relationship.

C. Threatened non-performance must be fundamental

Termination under this Article is permitted only where the main obligation is of such a kind that its non-performance would entitle the creditor to terminate. This applies also to a threatened delay in performance. If a debtor indicates that there will be performance but that it will be late this, in the absence of an agreed right to terminate, does not satisfy the requirements of the Article except where the threatened delay is so serious as to constitute a fundamental non-performance.

Illustration 2

B has agreed to build a house to O's design. B informs O that the double glazing specified by O is no longer available but that it can install double glazing from a different supplier which is almost identical. The failure to provide the double glazing originally specified would not, in these circumstances, be a fundamental non-performance, and O therefore cannot terminate under the Article.

Illustration 3

In January S contracts to sell goods to B for delivery on 1st March. In February S tells B that delivery will be a few days late. B can terminate immediately if in the circumstances this delay would be a fundamental non-performance, but not otherwise.

D. Inability or unwillingness to perform must be manifest

In order for the Article to apply it must be “clear” that the debtor is not willing or able to perform at the due date. An express repudiation by the debtor will satisfy this requirement but even in the absence of a repudiation the circumstances may make the situation clear. If the debtor's behaviour merely engenders doubt as to willingness or ability to perform, the creditor's remedy is to demand an assurance of performance.

E. Remedies consequent on termination

A later Article (III.–3:509 (Effect on obligations under the contract)) makes it clear that a creditor who exercises a right to terminate for anticipated non-performance has the same rights to damages as on termination for actual non-performance.

F. Time for notification of termination

The creditor may terminate at any time while it remains clear that there will be a fundamental non-performance by the debtor.

III.–3:505: Termination for inadequate assurance of performance

A creditor who reasonably believes that there will be a fundamental non-performance of a contractual obligation by the debtor may terminate if the creditor demands an adequate assurance of due performance and no such assurance is provided within a reasonable time.

COMMENTS

A. Purpose of rule

This Article is intended to protect the interests of a party to a contract who believes on reasonable grounds that the other party will be unable or unwilling to perform an obligation at the due date but who may be reluctant to terminate for anticipated non-performance in case it transpires that the other party would after all have performed. In the absence of a rule along the lines of this Article the creditor will be in a dilemma. To wait until the due date for performance may mean heavy losses if performance does not take place. To terminate for anticipated non-performance may mean a liability for damages if it is later found that it was not clear that the other party would commit a fundamental non-performance. The present Article enables the creditor to demand an assurance of performance, in default of which the remedy of termination can be safely used.

This rule is not found, at least in such a developed form, in the law of any of the Member States, though several have something similar that applies if one party has become insolvent. The general rule of “adequate assurance of performance” was developed in the American Uniform Commercial Code (article 2-609). It reflects what parties reasonably expect to be their rights and it has proved to be of considerable practical value.

B. Right to withhold performance

So long as the creditor’s reasonable belief in future non-performance by the debtor continues the creditor may withhold performance of reciprocal obligations, until adequate assurance of performance has been received. This is regulated by III.–3:401 (Right to withhold performance of reciprocal obligations))

C. Effect of non-receipt of adequate assurance

If the creditor does not receive adequate assurance of performance and still believes on reasonable grounds that performance will not be forthcoming, the creditor may terminate. On termination, the debtor’s failure to give the assurance requested is itself treated as a non-performance of the obligation, giving the creditor the right to damages where the deemed non-performance is not excused (III.–3:509 (Effect on obligations under the contract)).

Illustration 1

A, a caterer, contracts with B to cater for the reception at the wedding of B's daughter in three months' time. A month before the wedding B telephones A to discuss some outstanding details of the arrangements and is then told by A: "I am having some staff problems and there is a slight risk that I will not be able to organize the reception. But do not worry too much; everything should turn out all right." B is entitled to demand an adequate assurance that the reception will be provided. If this is given, as by A informing B that its staff difficulties have now been resolved, both parties remain bound by the contract and there is no non-performance of any obligation by A. If the assurance is not given, B is not expected to court disaster on the occasion of his daughter's wedding. He is entitled to terminate the contractual relationship, engage another caterer and recover from A any additional expense involved.

Illustration 2

A, a boat builder, agrees to build a yacht for B, to be delivered in three months' time. B stipulates that time of delivery is of fundamental importance. Soon after the making of the contract B learns that A's boatyard has been seriously damaged by fire. B is entitled to ask for an adequate assurance from A that the yacht will be delivered on time. A might give this assurance by showing that it has rented facilities to build the yacht at another yard.

D. What constitutes an adequate assurance

This will depend on the circumstances, including the debtor's standing, integrity and previous conduct in relation to the obligation and the nature of the event that creates uncertainty as to the ability and willingness to perform. In some cases the debtor's declaration of intention to perform will suffice. In other cases it may be reasonable for the creditor to demand evidence of the debtor's ability to perform.

Illustration 3

B enters into three successive contracts for the purchase of goods from S. Subsequently B defaults in payment of the price under each of the first two contracts. S is entitled to demand a bank guarantee of the purchase price under the third contract or other reasonable assurance that payment will be made and is not obliged to rely solely on B's promise of payment.

Sub-section 2: Scope, exercise and loss of right to terminate

III.-3:506: Scope of right when obligations divisible

(1) This Article applies where the debtor's obligations under the contract are to be performed in separate parts or are otherwise divisible.

(2) Where there is a ground for termination under this Section of a part to which a counter-performance can be apportioned, the creditor may terminate the contractual relationship so far as it relates to that part.

(3) The creditor may terminate the contractual relationship as a whole only if the creditor cannot reasonably be expected to accept performance of the other parts or there is a ground for termination in relation to the contractual relationship as a whole.

COMMENTS

Where a contract calls for a series of performances by one party, each with a matching counter-performance (typically, a separate price for each performance), the contractual obligations may be seen as divisible into a series of separate parts. The same may apply when the obligations under the contract are to be performed continuously over a period of time: even if performance is not broken down into discrete parts it may be possible to apportion payment on a daily or weekly basis.

If the debtor fails to perform one part, the creditor may want to put an end to the obligations of both parties relating to that part, including the obligation to accept performance of that part: for instance, in a contract for services the employer may want to arrange for someone else to do the work. However, it may not be appropriate for the creditor to have the right to terminate all the remaining obligations under the contract because the failure, although fundamental in relation to the relevant part of the debtor's obligations, may not be fundamental in relation to the whole. The part of the obligations not performed may not affect the rest of the contractual rights and obligations significantly, and the non-performance may not be likely to be repeated. In these circumstances, it is appropriate to allow the creditor to terminate the contractual relationship only in relation to the part of the debtor's obligation not performed, leaving the rest untouched. Only if the non-performance is fundamental in relation to the whole contract should the creditor be entitled to terminate the whole contractual relationship.

Illustration 1

The lessor of a machine under a 5 year lease, with rent payable monthly, announces in year 2 that a fault has been discovered in machines of that type and that the machine must be recalled immediately for repairs. Repairs will take at least 10 days but the machine will be returned as soon as possible. The lessor is unable to provide a replacement. This is a non-performance of obligations of the lessor under the contract. The lessee could simply reduce the price for the period during which the machine is out of service but needs to be able to hire a substitute machine for the period. The minimum period of hire of such a machine is a month. The lessee can terminate the contractual relationship for the month during which the machine will be out of service.

Illustration 2

An office cleaning company agrees to clean a law firm's office on Saturday of each week for a fixed price per week. One Saturday the cleaning company's

employees hold a one day strike. The law firm may terminate the obligations relating to that Saturday's work (including, in particular, the obligation to accept and pay for it) and bring in another cleaning firm to clean the office for that week. They may not terminate the contractual relationship as a whole unless it is clear that the strike will be repeated and that therefore there will be a fundamental non-performance of the whole of the cleaning company's obligation. This would then be a case of anticipated non-performance.

Illustration 3

The contract is as in Illustration 2. The cleaning work done in the first week is completely inadequate. It is clear that the cleaning company is trying to do the work using too few employees to cover an office of that size. The cleaning company refuses to use more employees. The law firm may terminate the contractual relationship as whole.

Sometimes one party's obligation to perform consists of distinct parts, and the non-performance affects only one of those parts, but the payment to be made for them is not split up into equivalent sums. If nonetheless the first party's performance is really divisible and the payment can be properly apportioned, the Article applies and termination is allowed in respect of the part affected.

Illustration 4

The facts are as in Illustration 2 but the price is a lump sum for the fifty week period. This price was initially calculated by the cleaning company simply by multiplying the weekly charge by 50. The creditor may terminate the contractual relationship, and thereby bring to an end the obligations of both parties, in respect of the week missed.

III.-3:507: Notice of termination

(1) A right to terminate under this Section is exercised by notice to the debtor.

(2) Where a notice under III.-3:503 (Termination after notice fixing additional time for performance) provides for automatic termination if the debtor does not perform within the period fixed by the notice, termination takes effect after that period or a reasonable length of time from the giving of notice (whichever is longer) without further notice.

COMMENTS

A. The requirement of notice.

Fair dealing requires that, as the minimum, a creditor who wishes to terminate for non-performance of an obligation should normally give notice to the defaulting debtor. The debtor must be able to make the necessary arrangements regarding goods, services and money. Uncertainty as to whether the creditor will accept performance or not may often

cause a loss to the debtor which is disproportionate to the inconvenience which the creditor will suffer by giving a notice. When performance has been made, passiveness on the side of the creditor may cause the debtor to believe that the former has accepted the performance even if it was too late or defective. If, therefore, the creditor wishes to terminate, notice must be given to the debtor within a reasonable time.

The laws of some Member States are more demanding, in that at least in principle they require a court order to terminate a contractual relationship. This traditional approach has been found to be inconvenient and is now subjected to more and more exceptions. Therefore these rules adopt the now more common rule that termination may be effected by notice to the other party.

Notice may be given in any form. It need not use any particular words or expressions. It need only indicate in one way or another that the creditor regards the contract or the contractual relationship as terminated. This may be indicated by, for example, words to the effect that a contract is ended or over or finished or rescinded; or that a contractual relationship (dealership, franchise, agency or whatever) is terminated or at an end; or that the creditor considers himself or herself to be no longer bound by the contract or, in a case of partial termination, by the contract as applied to a particular part of the performance; or that the debtor need not bother to perform. Whether rejection of a performance can be regarded as notice of termination will depend on the circumstances and on what else is said or done: it may only be a prelude to a withholding of payment until the debtor's obligation is properly performed.

B. When additional notice not required

Paragraph (2) deals with the situation where a notice under III.–3:503 (Termination after notice fixing additional time for performance) setting a reasonable period during which the defaulting debtor must perform has provided that at the end of the period termination will occur automatically if performance has still not been made. In such a case an additional notice of termination is not required.

III.–3:508: Loss of right to terminate

(1) If performance has been tendered late or a tendered performance otherwise does not conform to the contract the creditor loses the right to terminate under this Section unless notice of termination is given within a reasonable time.

(2) Where the creditor has given the debtor a period of time to cure the non-performance under III.–3:202 (Cure by debtor: general rules) the time mentioned in paragraph (1) begins to run from the expiry of that period. In other cases that time begins to run from the time when the creditor has become, or could reasonably be expected to have become, aware of the tender or the non-conformity.

(3) A creditor loses a right to terminate by notice under III.–3:503 (Termination after notice fixing additional time for performance), III.–3:504 (Termination for anticipated

non-performance) or III.-3:505 (Termination for inadequate assurance of performance) unless the creditor gives notice of termination within a reasonable time after the right has arisen.

COMMENTS

A. Notice must be given within reasonable time

A creditor is normally required to give notice of termination within a reasonable time or the remedy will be lost. This provision is required for the protection of the debtor who may be continuing to spend time, effort and money on performance.

However, paragraph (1) applies only where performance has been tendered, but is either late or defective. If performance is simply not tendered at all the creditor can wait. The creditor may hope that the debtor will still perform and should not be put into the position where allowing the debtor more time would cause a loss of a right to terminate. The effect of that would be that the greater the delay the more likely it would be that the right to terminate would have been lost. The creditor, who already has a difficult decision to make, should not be put under pressure to act on what may only be a belief or fear, but should be able to allow the situation to clarify itself further before taking any action.

When a tender of performance is due but has not been made, the courses of action open to the creditor will depend on the circumstances.

(1) The creditor does not know whether the debtor intends to perform or not but wants performance. In that case the creditor should request specific performance within a reasonable time after the creditor has, or could reasonably be expected to have, become aware of the non-performance.

(2) The creditor does not know whether the debtor intends to perform and either does not want the performance or is undecided. In this case the creditor may wait to see whether performance is ultimately tendered and may make a decision if and when this happens. The debtor may ask the creditor whether performance is still wanted, in which case the creditor must answer without delay or risk being in breach of the duty to act in accordance with good faith and fair dealing.

(3) The creditor has reason to know that the debtor is still intending to perform within a reasonable time, but no longer wishes to receive the performance. In this case it would be contrary to good faith for the creditor to allow the debtor to incur further effort in preparing to perform and then to terminate when the debtor eventually performs. The creditor in this situation would therefore have to notify the debtor that the performance will not be accepted, on pain of losing the right to terminate if the debtor does in fact perform within a reasonable time.

What is a reasonable time will depend upon the circumstances. For instance the creditor must be allowed long enough to be able to know whether or not defective goods will still serve their purpose. If delay in making a decision is likely to prejudice the debtor, for instance because the debtor may lose the chance to prevent a total waste of effort by concluding another contract, the reasonable time will be shorter than if this is not the case. If the debtor has tried to conceal the defects, a longer time may be allowed to the creditor.

B. When period begins to run

Paragraph (2) specifies the starting point for the period allowed under paragraph (1). Where the creditor has given the debtor a period of time to cure the non-performance under III.–3:202 (Cure by debtor: general rules) the time mentioned in paragraph (1) begins to run from the expiry of that period. In other cases the time begins to run from the time when the creditor has become, or could reasonably be expected to have become, aware of the tender or the non-conformity.

C. Time limit in cases equivalent to non-performance

Paragraph (3) applies the reasonable time rule to situations equivalent to non-performance – that is where additional time has been allowed for performance but the debtor has not complied, or there is anticipated not-performance by virtue of a repudiation by the debtor or other circumstances, or the debtor has failed to give an adequate assurance of performance when called upon to do so. See III.–3:503, 3:504 and 3:505. In these cases the creditor loses the right to terminate by notice unless notice of termination is given within a reasonable time after the right has arisen.

D. Other ways in which right to terminate lost

The creditor may also, on the application of the general rule on good faith and fair dealing, lose the right to terminate by indicating that the right will not be exercised on the ground of a non-performance that has occurred.

Illustration

A orders a sweater in a particular shade of red from Shop B. When the sweater arrives and A goes to collect it, she discovers that it is not the correct colour. She nonetheless says to B that she will take it. She cannot later reject the sweater and terminate the contractual relationship on the ground that it was not the correct colour. A would not, of course, be prevented from terminating on the ground of some other non-performance, e.g. if the sweater turns out to be defective and B fails to replace it within a reasonable time (see III.–3:202 (Cure by debtor: general rules)).

Unlike some laws, the Article does not prevent the creditor from terminating the contractual relationship simply because the creditor is unable to return a tangible benefit which has been received under the contract. Thus a buyer of goods which were not in

conformity with the contract may terminate the contractual relationship, and restitutionary remedies under this chapter will apply, despite the fact that the buyer cannot return the goods because, for example, they have been sold on.

Sub-section 3: Effects of termination

III.-3:509: Effect on obligations under the contract

(1) On termination under this Section, the outstanding obligations or relevant part of the outstanding obligations of the parties under the contract come to an end.

(2) Termination does not, however, affect any provision of the contract for the settlement of disputes or other provision which is to operate even after termination.

(3) A creditor who terminates under this Section retains existing rights to damages or a stipulated sum for non-performance and in addition has the same right to damages or a stipulated payment for non-performance as the creditor would have had if there had been non-performance of the now extinguished obligations of the debtor. In relation to such extinguished obligations the creditor is not regarded as having caused or contributed to the loss merely by exercising the right to terminate.

COMMENTS

A. What obligations are terminated?

The main point of termination is generally to terminate the debtor's unperformed obligation which gives rise to the right to terminate and any obligations of the creditor which are reciprocal to that obligation, including in particular the obligation to accept and pay for the debtor's performance. Essentially the creditor is saying "I do not want your performance any more and I am not going to pay for it. I regard myself as free to get what I want elsewhere." In the case of partial termination this will apply only in relation to the relevant part of the obligations and rights under the contract.

However, termination goes further than this. Paragraph (1) provides that the outstanding obligations or relevant part of the outstanding obligations of the parties under the contract come to an end. An obligation will be "outstanding" for this purpose if it has not been fully performed, whether or not it was due. An obligation will not be fully performed if what has been supplied is not in conformity with the terms of the contract.

There are exceptions (paragraph (2)) for contract terms relating to such matters as arbitration or the settlement of disputes.

This wider effect of termination is plainly necessary when the obligation which is not performed by the debtor is not the debtor's primary obligation.

Illustration 1

F, a farmer, is bound to allow C, a contractor, access over F's land in exchange for a monthly payment but subject to certain restrictions on the manner of use. C deliberately and blatantly disregards these restrictions. This is a fundamental non-performance of C's obligations regarding the manner of exercise of the right of access. F notifies C that, because of his conduct, access is no longer allowed and that F regards himself as no longer bound by the contract. This operates as a termination of the whole contractual relationship. F is no longer bound to allow access. C no longer has a right of access. C no longer has to pay future monthly payments.

It is important to note that termination operates for the benefit of both parties.

Illustration 2

A seller of goods fails to deliver on time and makes it clear that delivery will be so late that the buyer will no longer have a use for the goods. The buyer says "That's too late to be of any use to me. I'll get what I want elsewhere." Although no technical words are used, this is an effective notice of termination for non-performance. The main effect desired by the buyer is to terminate the buyer's own obligations to accept and pay for the goods. However, the buyer's notice also has the effect of terminating the seller's obligation to deliver the goods. If the buyer is unsuccessful in obtaining goods elsewhere it is too late to hold the seller to the original obligation.

B. Corresponding rights also terminated

It goes without saying that if obligations are terminated corresponding rights are also terminated.

Illustration 3

The facts are as in Illustration 1. The contractor cannot argue that a continuing right has been granted and cannot be taken away. Termination for the future of the farmer's obligation to allow access also terminates for the future the contractor's right to access.

C. No retrospective effect

The outstanding obligations of both parties under the contract "come to an end". This means that they have existed but are now extinguished for the future, subject to the exceptions already noted. Termination does not in general have retrospective effect.

Illustration 4

A cleaning company is employed to clean a law firm's office for 50 weeks at a fixed sum per week. In the 25th week the cleaning company ceases trading and

the law firm justifiably terminates the contractual relationship. The first 24 weeks' work have already been paid for; the payments are not affected by the termination.

The rule that termination has only prospective effect is, however, subject to the provisions later in this Chapter on the restitution of certain benefits received by the other party's performance or part-performance under the contract.

The rules set out in this Article represent what now seems to be commonly accepted principles. Some of the Member States' laws have in the past treated termination as having a retroactive effect, but this seems to have been modified by the jurisprudence to produce much the same effects as stated in the Article.

D. Certain rights and obligations survive

Paragraph (2) makes it clear that termination does not affect any provision of the contract for the settlement of disputes or any provision which is to operate even after termination.

Illustration 5

The holder of a patent licences a firm in another country to make its product but forbids it to sell it under anything but the patent holder's trademark. The licensee receives confidential information about production methods which it undertakes not to divulge so long as it is not publicly known. The contract contains a term referring all disputes to arbitration. The licensee, in breach of the licence, markets the patented product under its own brand name, and the patent holder justifiably terminates the contractual relationship. This extinguishes both parties' obligations for the future, including in particular the patent holder's own obligation to allow continued manufacture by the licensee. Termination ends the licensee's corresponding rights under the licence for the future but does not prevent the patent holder from seeking damages for non-performance of the contractual obligation; nor does it release the licensee from its obligation to keep the production information confidential. The dispute must be referred to arbitration.

E. Damages

In some cases the effect of termination is that the debtor no longer has a chance to perform an obligation which might have been performed if there had been no termination. Termination prevents there being a non-performance or further non-performance by the debtor. Nonetheless the creditor, if the whole contractual relationship is terminated, loses the whole benefit to which the creditor was entitled under the contract and the reason for that loss was the debtor's initial non-performance or the equivalent (anticipated non-performance or failure to give an adequate assurance of performance). Paragraph (3) therefore makes it clear that a creditor who exercises a right to terminate under this Section not only retains rights to damages for actual non-performance (which would follow anyway from the normal rules) but also has the same right to damages or a stipulated payment for non-performance as the creditor would have had if there had been actual non-performance of the now extinguished obligations of the debtor.

Illustration 6

A contracting company repudiates a contract by saying that there will be no performance because it is going to give priority to another job which will absorb all its resources for a number of years. The other party terminates for anticipated non-performance. The terminating party is entitled to damages for the loss caused by the contractor's failure to perform the obligations under the contract. The contractor cannot argue that it might have changed its mind and that it has been prevented from performing by the termination of the contract.

Illustration 7

A contracting company is guilty of such repeated and serious delays and incompetence that the other party concludes that it will never complete the job in a satisfactory way and terminates the contractual relationship. A court holds that there was fundamental non-performance by the contracting company. The other party is entitled to damages for loss caused not only by the past non-performance but also for loss caused by the non-performance of the rest of the contractual obligations. The contracting company cannot argue that it was prevented by the termination from rendering such further performance.

The second sentence of paragraph (3) is inserted so as to avoid the possibility of any argument based on III.-3:101 (Remedies available) paragraph (3) (which provides that the creditor may not resort to any remedies to the extent that the creditor caused the debtor's non-performance) or III.-3:704 (Loss attributable to creditor) (which provides that the debtor is not liable for loss suffered by the creditor to the extent that the creditor contributed to the non-performance or its effects).

In long-term contracts involving periodic performances there might be thought to be a danger of injustice in the rule under paragraph (3). If there is a contract for monthly deliveries over a period of ten years, and if the purchaser terminates the whole contractual relationship merely because there is a non-performance, which is unlikely to be repeated, in relation to one delivery at the end of the second year it might seem unfair to allow the creditor to recover damages for loss caused by the non-performance of the obligations for the remaining eight years. In such a case it would not be unrealistic for the debtor to argue that it was perfectly willing and able to perform the rest of the contractual obligations and that in reality it was the creditor's act in terminating which caused any loss the creditor suffered in relation to the last eight years. The answer is that in such a case the creditor would not be able to terminate the whole contractual relationship under this Section. The creditor would at most be able to terminate in relation to the month in which the defective delivery occurred. Indeed if the creditor insisted on withdrawing from the whole relationship because of one defective delivery it would itself be guilty of a repudiation of the contract and would be liable in damages to the supplier.

One the other hand, if the supplier's breach was intentional and gave the purchaser good grounds for believing that it could no longer count on the supplier's performance in the future (cf III.-3:502 (Termination for fundamental non-performance) paragraph (2)(b)),

the purchaser would be entitled to terminate the contractual relationship as a whole and in principle would be entitled to claim damages for loss caused by the non-performance of all the supplier's obligations. In practice, however, the purchaser's damages will be limited because it will be able to make alternative arrangements to cover its needs, and it will not be entitled to damages for any loss that it could have avoided by doing so (cf III.-3:705 (Reduction of loss)). However, if there are foreseeable losses that it is not able to prevent (for example if the price of "forward contracts" for the goods in question has risen), it may claim for them.

There may be cases where at the time of termination both parties have rights to damages for past non-performances by the other. The debtor's rights are not lost by termination. This follows from the general rules on damages.

F. Move away from retroactive effect

The rules set out in this article represent what now seems to be commonly accepted principles. Some of the Member States' laws have in the past treated termination as having a retroactive effect, but this seems to have been modified by the jurisprudence to produce much the same effects as stated in this article

III.-3:510: Property reduced in value

A party who terminates under this Section may reject property previously received from the other party if its value to the first party has been eliminated or fundamentally reduced as a result of the other party's non-performance. On such rejection any obligation to pay for the property is extinguished.

COMMENTS

Under many different types of contract there is a possibility that the creditor who terminates may have received from the other party some property which is of no further value to the creditor because of the debtor's non-performance itself or because the creditor has terminated and will therefore not receive the rest of the performance. In such cases the creditor should have the right to reject the useless property and this Article so provides.

Illustration 1

A firm of accountants agrees to lease a computerised accounts system, which requires a particular kind of computer. The lessor supplies the hardware but completely fails to supply the software. The accountants have no use for the hardware alone and may reject it.

This Article may also apply where the contract is to be performed in distinct instalments, if failure to deliver a later instalment makes the earlier instalments useless.

Illustration 2

A complete computer system is to be installed and paid for one component at a time so that it can be fitted into a new office as the building is being built. An essential item is not delivered and the buyer terminates. The buyer may reject the components already received.

In all the cases suggested the creditor could in the alternative claim damages or keep the property and reduce the price for the reduced value that the property received now has. However it will often be more convenient for the creditor simply to return the unwanted property than to have to dispose of it some other way and, since the creditor is the aggrieved party, it seems appropriate to give the creditor the right to reject. There will be a considerable advantage in rejecting the property if it has not yet been paid for, as the creditor can avoid having to pay even a reduced price. This is made clear by the second sentence of the Article.

Sub-section 4: Restitution

III.-3:511: Restitution of benefits received by performance

(1) On termination under this Section a party (the recipient) who has received any benefit by the other's performance of obligations under the contract is obliged to return it. Where both parties have obligations to return, the obligations are reciprocal.

(2) If the performance was a payment of money, the amount received is to be repaid.

(3) To the extent that the benefit (not being money) is transferable, it is to be returned by transferring it. However, if a transfer would cause unreasonable effort or expense, the benefit may be returned by paying its value.

(4) To the extent that the benefit is not transferable it is to be returned by paying its value in accordance with III.-3:513 (Payment of value of benefit).

(5) The obligation to return a benefit extends to any natural or legal fruits received from the benefit.

COMMENTS

A. General

When a contractual relationship is terminated for fundamental non-performance or the equivalent under this Section it may easily happen that one or other party is left with some property or other benefit which ought to be returned if unfairness is to be avoided.

Illustration 1

A firm of accountants agrees to lease a computerised accounts system, which requires a particular kind of computer. The lessor supplies the hardware but completely fails to supply the software. The accountants have not yet paid anything under the contract. They terminate for fundamental non-performance. They should not, however, be allowed to keep the hardware.

This Sub-section regulates the circumstances in which, the way in which and the extent to which restitution is to be made when a contractual relationship is terminated for fundamental non-performance or the equivalent.

This Article provides wide and flexible restitutionary remedies, as are found in most (but not all) the laws of the Member States, in order to ensure that neither party is left unjustly enriched after termination of the contractual relationship. It must be read together with the following Article, which defines its scope of application

B. Requirement of restitution

The basic rule is that the recipient is obliged to return any benefit received by the other's performance. The way in which restitution is effected depends on the nature of the benefit. Where money has been received, the amount received (i.e. not necessarily the actual notes) is to be repaid. Transferable property other than money must be returned in kind. In many cases, however, an actual return is not possible. This applies to work and labour, services, the hiring out of goods, the letting of premises, and the carriage and custody of goods. A party who has received a performance of this kind cannot give it back. In contracts for sale or barter restoration may become impossible when the goods have perished or have been consumed or resold. In these situations the recipient is obliged to pay the value of the benefit.

C. Repayment of money paid

Under the Article a party may claim back money paid in advance for a performance which the party did not receive because the obligation was extinguished before it was fully performed. This rule has general application where a party who has prepaid money rightfully rejects performance by the other party or where the latter fails to effect any performance. It applies equally, for example, to contracts of sale, contracts for work and labour and contracts of lease.

The party claiming repayment of money paid may also claim interest (III.-3:708 (Delay in payment of money)).

D. Return of transferable property other than money

The Article provides for the actual return of property other than money which is of a type which can be restored. On the extinction of the obligation by termination under the Section such property must be re-transferred.

Illustration 2

A contract called for A to deliver goods to be paid for by B upon their receipt. B did not pay for the goods on receipt. This, in the circumstances, is a fundamental non-performance. A may terminate the contractual relationship and claim back the goods from B.

The rule applies to contracts under which the obligations are to be performed in parts. If the creditor is entitled to terminate in respect of a part, the creditor may recover property transferred under that part of the contract.

Even if the actual subject-matter of an obligation is not returnable, restoration may be possible of things which attach to the subject-matter. Know-how and literary works are written on paper, paintings are made on canvas, sculptures cast in bronze. Tangible things which in this way materialise the product of the mind may be restored on termination. These things often have a value.

Illustration 3

A famous artist contracts with B to make illustrations for a new edition of Homer's Odyssey to be published by B; the copyright is to vest in B. When B receives the drawings he does not pay for them. The artist may terminate the contractual relationship and claim the illustrations back; the copyright must also be re-vested in him.

E. Return of property in case of bad bargains

Return may be claimed when one party has fully performed obligations to transfer property under a contract and only the other party's obligation to pay the price remains outstanding. It does not matter that the property is worth more than was to be paid for it so that by obtaining return the party escapes a bad bargain.

Illustration 4

A has sold a Renoir painting to B for €200,000; the true value of the painting is over €250,000. When the picture is delivered, B does not pay for it and makes it clear that he has no intention of paying for it. A is entitled to terminate and claim back the painting.

F. Return too onerous

Paragraph (3), second sentence, allows the value to be paid where the return of property would involve the recipient in an unreasonable effort or expense.

Illustration 5

A has painted a fresco which has been mounted on a wall in B's house and for which B has not paid A. Although it would be physically possible to dismantle the fresco the costs would be disproportionately high. A cannot claim back the fresco but only a payment representing its value.

G. Payment of value of non-transferable benefits

To the extent that a benefit is not transferable its value must be paid. Further provision on the calculation of value is made in III.–3:513 (Payment of value of benefit).

H. Fruits also to be returned

It may happen that something received in part performance or attempted performance of an obligation produces natural fruits (e.g. lambs or calves) or legal fruits (e.g. rents or interest or dividends) while in the possession of the recipient and before it can be returned. In such a case the fruits must be handed over along with the return of what was received.

Illustration 6

F has bought ten sheep guaranteed to be pregnant by a particular type of ram. When the lambs are born it is clear that they are of another type. F terminates for fundamental non-performance and reclaims the price. F must return both the sheep and the lambs.

III.–3:512: When restitution not required

(1) Restitution is not required where the performance was due in separate parts or was otherwise divisible and what was received by each party resulted from due performance of a part for which counter-performance was duly made.

(2) Paragraph (1) does not, however, apply if what was received by the terminating party was properly rejected under III.–3:510 (Property reduced in value) or if the value of a non-transferable benefit received by the terminating party has been eliminated or fundamentally reduced as a result of the other party's non-performance.

COMMENTS

A. Application to obligations to be performed in parts or otherwise divisible

Where an obligation is to be performed in parts or instalments or is otherwise divisible, (for example, if it is to be performed continuously over a period of time and separate payments can be apportioned to units of time within the period), the duly completed parts of the performance on both sides do not normally have to be unravelled. The rules on restitution apply, however, to payments made in respect of so much of the obligation as was not fully performed.

Illustration 1

A has given B advance payment for the construction of 12 houses. B builds only 3 houses, and A terminates the contractual relationship. A can claim back the

advance payment for the 9 houses which were not built but not for the three which were built.

Illustration 2

Company X has leased machinery from company Y for a period of 24 months. Y has to inspect the machinery once a week and perform maintenance operations. Payment of rent is to be made monthly. For 10 months the obligations are properly performed on both sides. Then Y's performance becomes fundamentally unsatisfactory to such an extent that X can hardly use the machinery. After 3 months of this, X concludes that it cannot rely on Y's performance improving for the future and terminates the whole contractual relationship for fundamental non-performance. X will have a claim for restitution of all or part of the rent paid for the 3 months when Y's obligations were not performed but has no claim in relation to the first 10 months when the parties' obligations were performed on both sides.

B. Exception for cases where what was received is now of no or little value to recipient

Even where an obligation is to be performed in divisible parts or over a period of time, and even where there has been full performance on both sides in respect of one part or period, there is a possibility that one party may have received from the other some property which is of no value to the recipient because the termination of the contractual relationship means that the recipient will not receive the rest of the performance. In such cases the recipient has the right under III.-3:510 (Property reduced in value) to reject the useless property and is relieved of the obligation to pay the price. If the price has already been paid paragraph (2) of the present Article enables it to be recovered.

Illustration 3

A complete computer system is to be installed and paid for one component at a time so that it can be fitted into a new office as the building is being built. An essential item is not delivered and the buyer terminates the contractual relationship for fundamental non-performance. The buyer may reject the components already received and recover the price paid for them.

The recipient could in the alternative claim damages or a reduction in the price for the reduced value that the property received now has. However it will often be more convenient simply to return the unwanted property than to have to dispose of it some other way. There will be a considerable advantage in rejecting the property if it has not yet been paid for, as the recipient can thus avoid having to pay even a reduced price.

III.-3:513: Payment of value of benefit

(1) The recipient is obliged to:

(a) pay the value (at the time of performance) of a benefit which is not transferable or which ceases to be transferable before the time when it is to be returned; and
(b) pay recompense for any reduction in the value of a returnable benefit as a result of a change in the condition of the benefit between the time of receipt and the time when it is to be returned.

(2) Where there was an agreed price the value of the benefit is that proportion of the price which the value of the actual performance bears to the value of the promised performance. Where no price was agreed the value of the benefit is the sum of money which a willing and capable provider and a willing and capable recipient, knowing of any non-conformity, would lawfully have agreed.

(3) The recipient's liability to pay the value of a benefit is reduced to the extent that as a result of a non-performance of an obligation owed by the other party to the recipient:

(a) the benefit cannot be returned in essentially the same condition as when it was received; or

(b) the recipient is compelled without compensation either to dispose of it or to sustain a disadvantage in order to preserve it.

(4) The recipient's liability to pay the value of a benefit is likewise reduced to the extent that it cannot be returned in the same condition as when it was received as a result of conduct of the recipient in the reasonable, but mistaken, belief that there was no non-conformity.

COMMENTS

A. Non-transferable benefit

It frequently happens that after a contractual relationship has been terminated one party is left with a benefit which cannot be returned - either because the benefit is the result of work which cannot be returned, or because property which has been transferred has been used up or destroyed - but for which the party has not paid. The other party may have a claim for the price, but this will depend upon the agreed payment terms and the price may not yet be payable. The other party may have a claim for damages, but the party who has received the benefit may be the creditor in the relevant obligation, or may be a debtor who is not liable for damages because the non-performance was excused. It would be unjust to allow the party to retain this benefit without paying for it.

Illustration 1

A contract to build a garage on to a house provides that the builder is to be paid upon completion of the work. After doing two-thirds of the work, the builder becomes insolvent and stops work. The employer terminates the contractual relationship and gets another builder to finish the garage. The amount the employer has to pay the second builder is less than the original contract price and the employer receives a net benefit. Under the Article the employer must pay the first builder a reasonable sum for the value of the work received. The employer might have a claim against the first builder for damages for the inconvenience caused, but that is a separate matter.

Illustration 2

A purchases from B a car for €12,000. As a result of a road accident, the car is damaged beyond economic repair and is later disposed of for scrap. An examination of the car after the accident reveals, however, that the car was fitted with defective cylinders. In view of that defect the car was actually only worth €4,000 when A bought it, although it would have been worth €8,000 if the cylinders had been of the quality demanded by the contract. On the basis of the severe defect, A terminates for fundamental non-performance. A is entitled to a return of the purchase price but is liable to pay B the value of the car as this cannot be returned. As the parties agreed a price and A obtained a performance only half as valuable as the one he should have received under the contract, B is entitled to retain half the price as representing the value of the benefit received by A.

The rule in this Article seems to represent a common position, though in some systems the risk of accidental loss or damage to property transferred is placed on the party to whom it would otherwise have been returned.

III.–3:514: Use and improvements

(1) The recipient is obliged to pay a reasonable amount for any use which the recipient makes of the benefit except in so far as the recipient is liable under III.–3:513 (Payment of value of benefit) paragraph (1) in respect of that use.

(2) A recipient who has improved a benefit which the recipient is obliged under this Section to return has a right to payment of the value of improvements if the other party can readily obtain that value by dealing with the benefit unless:

- (a) the improvement was a non-performance of an obligation owed by the recipient to the other party; or*
- (b) the recipient made the improvement when the recipient knew or could reasonably be expected to know that the benefit would have to be returned.*

COMMENTS

The rule in paragraph (1) obliges the recipient of a returnable benefit to pay a reasonable amount for any use made of the benefit. The exception in the second part of the paragraph prevents a double liability from arising. In so far as the use of the benefit led to a reduction in the value of the (returnable) benefit the debtor is already obliged to pay recompense under III.–3:513 (Payment of value of benefit) paragraph (1) and so does not need to pay again.

Illustration 1

A purchases a kitchen stove from B for €500. A uses the stove for five months, at which time A notices that the frame of the oven is becoming seriously distorted. A exercises her right to terminate the contractual relationship for fundamental non-

performance. The value of the stove in its much changed condition is €50. As the change in condition is the result of A's use of the stove in the legitimate assumption that it was not defective, A is not liable to pay recompense for the deterioration in the stove's condition: see III.-3:513 (Payment of value of benefit) paragraph (4), reducing liability under paragraph (1) of that Article to nil. However, A is liable under paragraph (1) of the present Article to pay a reasonable amount for the use of the stove for five months. The reasonable amount will take account of the fact that the stove which A has used was defective and will not reflect the full sum that would be appropriate for the use of a fully-functioning appliance.

The rule in paragraph (2) deals with what is functionally the reverse situation – namely, where the recipient has improved the benefit so that the other party would actually be better off on the return of the benefit than if there had been no improvements. The improver has in such circumstances a right to payment of the value of the improvements but only if the other party can readily obtain that value by dealing with the benefit. It would be unfair to saddle the other party with a liability to pay for improvements which had not been asked for and which could not be translated into realised value. There are two other restrictions in sub-paragraphs (a) and (b) of paragraph (2). The policy behind both is that the improver has no right to payment for improvements if the improver was, so to speak, in the wrong in making the improvements. Sub-paragraph (a) deals with the situation where the improvement was actually a non-performance of an obligation owed to the other party. Clearly in this situation the improver cannot be allowed to profit from the non-performance. Sub-paragraph (b) deals with the situation where the improver knew or could reasonably be expected to have known at the time of making the improvements that the benefit would have to be returned. This can be regarded as an application of the principle of good faith.

Illustration 2

D, a motor cycle dealer, purchases a dozen prestige motor bikes from their manufacturer M. D customises the bikes by replacing various parts with more expensive components of superior quality and reputation. D is unable to re-sell the bikes because, contrary to the terms of the contract, the bike frames in their delivered condition do not satisfy safety regulations which govern the use of motor cycles on the road in D's country. Restoring the bikes to their original condition is no longer possible as most of the components have been welded to the bikes. While, on termination of the contractual relationship, D is liable to return the bikes to the manufacturer under III.-3:511 (Restitution of benefits received by performance) paragraph (3), M is liable to pay to D the value of the improvements made to the bikes if M can sell them without difficulty and thus realise that value.

III.-3:515: Liabilities arising after time when return due

(1) The recipient is obliged to:

- (a) pay the value (at the time of performance) of a benefit which ceases to be transferable after the time when its return was due; and*
- (b) pay recompense for any reduction in the value of a returnable benefit as a result of a change in the condition of the benefit after the time when its return was due.*

(2) If the benefit is disposed of after the time when return was due, the value to be paid is the value of any proceeds, if this is greater.

(3) Other liabilities arising from non-performance of an obligation to return a benefit are unaffected.

COMMENTS

Where the benefit conferred under a contract ceases to be transferable or deteriorates before termination of the contractual relationship takes place, the legal consequences are determined by III-3:513 (Payment of value of benefit). The present Article, by contrast, governs the consequences for the recipient's liability under III.-3:511 (Restitution of benefit received by performance) paragraph (3) to return the benefit by transferring it when the benefit ceases to be transferable or its condition deteriorates in the period *following* termination of the contractual relationship and before return of the benefit. As provided for by paragraph (3), these rules partially displace the general rules which otherwise apply in the case of a non-performance of the obligation to return the benefit.

Illustration 1

In 2006 W purchases from Z a substantial stamp collection on the agreed basis that the collection includes a complete series of South African commemorative stamps for 1952 to 1968. A sale price of €22,000 is agreed. Z terminates the contractual relationship after W fails to pay the third of the ten instalments due. After termination, W, instead of returning the collection, arranges for it to be auctioned, where it is sold in 2007 for €26,500. W is liable to pay to Z the proceeds of sale from the auction in accordance with paragraph (2), but can set-off the right to repayment of €6,600 paid by W before termination.

Section 6: Price reduction

III.-3:601: Right to reduce price

(1) A creditor who accepts a performance not conforming to the terms regulating the obligation may reduce the price. The reduction is to be proportionate to the decrease in the value of what was received by virtue of the performance at the time it was made compared to the value of what would have been received by virtue of a conforming performance.

(2) A creditor who is entitled to reduce the price under the preceding paragraph and who has already paid a sum exceeding the reduced price may recover the excess from the debtor.

(3) A creditor who reduces the price cannot also recover damages for the loss thereby compensated but remains entitled to damages for any further loss suffered.

(4) This Article applies with appropriate adaptations to a reciprocal obligation of the creditor other than an obligation to pay a price.

COMMENTS

A. The principle of price reduction

Under this Article the creditor is entitled to a reduction in the price where the debtor's performance is incomplete or otherwise fails to conform to the terms regulating the obligation. The remedy is given whether the non-conformity relates to quantity, quality, time of delivery or otherwise. The remedy is designed both as an alternative to damages (see Illustration 2 below) and for cases where the debtor is excused from liability for damages (see Comment B below). The Article applies only where the creditor accepts the non-conforming performance. In other cases, the remedy is either to pursue a restitutionary claim under III.–3:511 (Restitution of benefits received by performance) or to claim damages under Section 7.

Price reduction is a normal remedy in most European legal systems. The common law systems, however, did not know it as such until they implemented the Directive on certain aspects of the sale of consumer goods and associated guarantees (1999/44/EC), which refers to price reduction; but in most cases they reached broadly similar results by other means.

The amount of the price reduction is proportional to the reduction in the value of what is received compared to the value of what would have been received if there had been conforming performance. In some cases the value received will be directly related to the proportion of the obligation performed and the price may simply be reduced accordingly.

Illustration 1

S contracts to sell 50 tonnes of coffee to B at a price of €2,400 a tonne. S tenders only 30 tonnes. B may accept the short tender and reduce the price under this Article from €120,000 to €72,000 (see Illustration 3). Alternatively B can reject the short tender, in which case it can either claim recovery of the price under III.–3:511 (Restitution of benefits received by performance) or claim damages under Section 5, but it cannot invoke the present Article.

In other cases the value of the performance may be reduced by a greater (or less) proportion.

Illustration 2

B agrees to build a house for O for €150,000. If the work had been properly executed the house would have been worth €100,000 when completed, but because of B's defective workmanship it is worth only €80,000. As an alternative to claiming damages of €20,000, O may withhold or recover one-fifth of the price, i.e. €30,000.

B. Price reduction available even where non-performance excused

The fact that a shortfall in performance is excused does not affect the creditor's right to a price reduction under this Article, for the only remedies which are excluded in the case of an excused non-performance are specific performance and damages.

Illustration 3

S in Marseilles contracts to sell 20 hospital scanning machines to B in London. As the result of the introduction of a quota system governing the export of scanning machines S is only able to supply B with 15 machines. S's non-performance is excused but if B decides to accept the 15 machines it is entitled to a price reduction of 25 per cent.

C. Price reduction may be obtained before or after payment

The creditor may obtain a price reduction under this Article either by withholding payment, if the price has not yet been paid, or by recovering the amount of the price reduction if the price has already been paid.

D. Price reduction is alternative to damages for reduction in value

A creditor who reduces the price under this Article cannot also claim damages for the difference in value between what was received and what would have been received by virtue of conforming performance (see Illustration 1). The two remedies are incompatible so that there is no right to cumulate them. However, other loss remains recoverable within the limits laid down by Section 7.

Illustration 4

The facts are as in Illustration 2. O cannot live in the house until the defects in it have been put right and incurs a loss of €500 in renting an apartment to live in meanwhile. The €500 remains recoverable whichever of the above remedies is pursued.

Section 7: Damages and interest

III.-3:701: Right to damages

(1) The creditor is entitled to damages for loss caused by the debtor's non-performance of an obligation, unless the non-performance is excused.

(2) The loss for which damages are recoverable includes future loss which is reasonably likely to occur.

(3) "Loss" includes economic and non-economic loss. "Economic loss" includes loss of income or profit, burdens incurred and a reduction in the value of property. "Non-economic loss" includes pain and suffering and impairment of the quality of life.

COMMENTS

A. Scope of Article

The Article covers damages for non-performance of an obligation which is within the scope of these rules. It does not apply to damages recoverable under Book VI (Non-Contractual Liability Arising out of Damage Caused to Another); they are recoverable not for non-performance of an obligation but for breach of a more general duty not to harm others in certain ways or circumstances. Also the rules in this Section are not intended to be used, or used without modification, in relation to damages for non-performance of public law obligations or family law obligations.

It has already been noted that damages cannot normally be recovered for non-performance of a monetary obligation unless there are exceptional circumstances which make interest an insufficient remedy. It follows that there could not normally be a claim for damages for non-payment of an award of damages.

B. No damages without loss

This Article enables the creditor to recover damages whenever the creditor suffers loss from the debtor's unjustified failure to perform an obligation. The section does not provide for nominal damages for a breach which has caused the creditor no loss.

A few of the laws permit the creditor in particular circumstances to recover the gains made by the debtor through the non-performance, even if these exceed the loss to the creditor. The situations are so limited that this approach has not been adopted in these rules.

C. No fault necessary

Where a debtor's obligation is to produce a given result, failure to do so entitles the creditor to damages whether or not there has been fault by the debtor, except where performance is excused. Where the obligation is not to produce a result but merely to use reasonable care and skill the debtor is liable only if that obligation has not been performed, that is to say if the debtor has not exercised the care and skill required. In the absence of a term specifying the required degree of care and skill, this is equivalent to the commission of a fault.

Illustration 1

A contracts to supply and install in B's house a central heating system that will provide a temperature of up to 22 degrees when the outside temperature is no greater than 0 degrees. A installs the system but despite the exercise of all reasonable care and skill on its part the maximum temperature it can achieve is 18 degrees. A is liable for damages.

Illustration 2

A, a surgeon undertakes to carry out a major operation on B. Despite all reasonable care and skill on A's part, the operation is unsuccessful. A is not liable, for the undertaking was merely to act with due care and professional skill, not to guarantee a successful outcome.

D. All forms of failure in performance covered

This Article applies to all forms of failure in performance. There is no requirement that the creditor serve a notice to perform before being able to recover damages for delay.

Illustration 3

S agrees to build a boat for B for €100,000. No time for completion is fixed by the contract but a reasonable time would be six months. S takes nine months to complete the boat and make it available to B. S is liable for damages for the delay, whether or not B has given notice requiring the boat to be finished within a given period.

E. Loss that would not have occurred without the failure in performance

The creditor may not recover damages for loss not caused by the failure to perform. However, not every intervening event, even if unforeseeable, which exacerbates the loss falls within this principle. The question in each case is whether that event would have had an impact on the loss if the failure in performance had not occurred. Only if this question is answered in the affirmative will the event in question be treated as breaking the chain of causation.

Illustration 4

S agrees to sell to B machinery which S knows is required by B to manufacture goods in its factory. The machinery is due to be delivered on 1st June but S fails to make delivery. B is losing profit at the rate of €10,000 for each week's delay. This is a normal level of profit for a business of this kind. On 29th June a fire breaks out in B's factory, which is burnt to the ground. On 16th July S delivers the machinery. B, which would not have been able to put the machinery to use elsewhere during this period, can recover €40,000 damages for the loss of profit up to 29th June but nothing for loss suffered beyond that date.

Illustration 5

In June a company, S, in London agrees to sell a quantity of machine guns to a weapons dealer, B, in Serbia for £50,000, the guns to be shipped by 30th September against payment. In July S decides that it does not wish to support B's arms business and informs B that it does not intend to ship the guns. In August the British government places an embargo on the exportation of arms to the former Yugoslavian Republics and this is still in force when B's claim for damages is heard 18 months later. B is not entitled to damages.

Illustration 6

In June S in Paris contracts to sell a Seurat painting to B in Hamburg for €1,000,000, the painting to be shipped to B in Hamburg by the end of August. Because of the delays on the part of its staff S is unable to arrange shipment earlier than 1st October. On 5th September the French government impose a ban on the exportation of works of art without a licence, and despite using its best endeavours S is unable to obtain a licence to export the Seurat painting. The value of the painting at the end of August is considered by experts to be €2,000,000. B is entitled to damages of €1,000,000, the difference between the value of the painting and its price, since but for S's delay in shipping the painting its export would not have been affected by the ban.

F. Non-economic loss

Recoverable loss is not confined to economic or pecuniary loss but may cover, for example, pain and suffering, inconvenience, mental distress and any other impairment of the quality of life resulting from the failure to perform.

Illustration 7

A books a package holiday from B, a travel organisation. The package includes a week in what is described as spacious accommodation in a luxury hotel with excellent cuisine. In fact, the bedroom is cramped and dirty and the food is appalling. A is entitled to recover damages for the inconvenience and loss of enjoyment suffered.

Of the issues dealt with by this Article, the recovery of damages for non-economic loss, particularly for disappointment, is the principal one on which the national laws differ: see Case C-168/00 *Simone Leitner v TUI Deutschland* [2002] ECR I-2631. Paragraph (3) follows the guidance given by the ECJ in that case.

G. Future loss

The loss recoverable by the creditor includes future loss, that is, loss expected to be incurred after the time damages are assessed. This requires the court to evaluate two uncertainties, namely the likelihood that future loss will occur and its amount. As in the case of accrued loss before judgment this covers both prospective expenditure which would have been avoided but for the non-performance and gains which the creditor could

reasonably have been expected to make if the non-performance had not occurred. Future loss often takes the form of the loss of a chance.

Illustration 8

E is appointed sales manager of F's business under a three-year service contract. She is to be paid a salary and a commission on sales. After 12 months E is wrongfully dismissed, and despite reasonable efforts to find an alternative post she is still out of work when her action for wrongful dismissal is heard six months later. E is entitled to damages not only for her accrued loss of six months salary but also for the remaining 18 months of her contract, due allowance being made for her prospects of finding another job meanwhile. She is also entitled to damages for loss of the commission she would probably have earned.

III.-3:702: General measure of damages

The general measure of damages for loss caused by non-performance of an obligation is such sum as will put the creditor as nearly as possible into the position in which the creditor would have been if the obligation had been duly performed. Such damages cover loss which the creditor has suffered and gain of which the creditor has been deprived.

COMMENTS

A. Scope of Article

The Article applies only to the measure of damages for loss caused by non-performance of an obligation. It does not therefore apply to damages for loss caused by other conduct, however, reprehensible it may be and even if it amounts to a clear breach of some general duty, such as the duty to act in accordance with good faith and fair dealing. In such cases, any remedy for breach of the duty will depend on the provision creating the duty. For example II.-7:204 (Liability for loss caused by reliance on incorrect information) provides that a party who has concluded a contract in reasonable reliance on incorrect information given by the other party in the course of negotiations has a right to damages for loss suffered as a result if the provider of the information believed the information to be incorrect or had no reasonable grounds for believing it to be correct. Here the damages are not designed to put the party in the position which would have prevailed if the information had been correct but rather in the position which would have prevailed if no contract had been concluded in reliance on the information. Similarly II.-7:214 (Damages for loss) provides that damages for loss suffered as a result of being induced to conclude a contract by mistake, fraud, coercion, threats or unfair exploitation should generally be such as to place the creditor as nearly as possible in the position in which the creditor would have been if the contract had not been concluded.

B. Nature of interest protected

This Article combines the widely accepted "expectation interest" basis of damages for non-performance of an obligation and the traditional rule of "*damnum emergens*" and "*lucrum cessans*" of Roman law, namely that the creditor is entitled to compensation of

such amount as will provide the value of the defeated expectation. In a contract for the sale of goods or supply of services this is usually measured by the difference between the contract price and the market or current price; but where the creditor has made a cover transaction then in the conditions set out in III.–3:706 (Substitute transaction) the creditor can elect to claim the difference between the contract price and the cover price. The sums recoverable as general damages embrace both expenditure incurred and gains not made. Damages under this Article are not intended to provide restitution of benefits received; this remedy may however be available on termination of a contract in the circumstances described in III.–3:511 (Restitution of benefits received by performance) .

Illustration 1

S sells a car to B for €5,000, warranting that it is an X model. In fact it is an S model, an older version the market value of which is €1,500 less than the value of an X model. The contract price is not as such relevant to the computation of damages. S is entitled to damages of €1,500, the difference between the value of the car as warranted and its value as delivered.

C. Other loss

In addition to the primary claim for loss of what was due (that is, the loss which any creditor would be likely to suffer from the non-performance) the creditor can recover for foreseeable loss resulting from the particular circumstances. Such loss is sometimes termed "consequential loss".

Illustration 2

B buys a washing machine in a sale at a special price of €200. The normal cost is €300. Because of a serious defect in the machine, garments put into it for washing, worth €50, are ruined. On rejecting the machine B is entitled to recover not only the price paid and €100 for loss of bargain but also the sum of €50 for consequential loss.

The damages recoverable may include a sum to represent interest upon the amount of the loss from the date at which the loss was incurred to the date of payment.

D. Computation of losses and gains

The creditor must bring into account in reduction of damages any compensating gains which offset the loss; only the balance, the net loss, is recoverable. Similarly, in computing gains of which the creditor has been deprived, the cost which would have been incurred in making those gains is a compensating saving which must be deducted to produce a net gain. Compensating gains typically arise as the result of a cover transaction concluded by the creditor. But it is for the debtor to show that the transaction generating the gains was indeed a substitute transaction, as opposed to a transaction concluded independently of the default. A compensating saving occurs where the future performance from which the creditor has been discharged as the result of the non-performance would have involved the creditor in expenditure.

Illustration 3

O, a construction company which owns a piece of equipment for which it has no immediate need, enters into an agreement to lease the equipment to H for a year at a rental of €1000 a month. After three months, O terminates the lease and repossesses the equipment because of H's default in payment of the rent. Two months later, O succeeds in re-letting the equipment for seven months at a rent of €1200 a month. O is entitled to the rent due and unpaid at the time it terminated the original lease and to damages for loss of future rental income, but its claim for the two months' loss of rent after termination, i.e. €2000, is reduced by €1400, the additional rental it will receive over the remaining 7 months of the original agreement.

Illustration 4

S, a commodity dealer, contracts to sell to B 50 tonnes of soyabean meal at a price of €300,000 a tonne for delivery on 1st August. On that date, when the price of soyabean meal has fallen to €250,000 a tonne, B fails to take up and pay for the meal. A week later S sells 50 tonnes of soyabean meal to C at €375,000 a tonne. Even if the market price rule (that is to say the rule that, in the case of goods of a kind available on a market, the normal measure of damages is taken to be the difference between contract price and market price) did not apply, S would not have to bring into account in its claim against B the extra profit on its sale to C, in the absence of evidence that its transaction was a substitute for the contract with B.

E. “Unless otherwise provided”

The measure of damages set out in the Article applies only unless otherwise provided. We have already seen that some of these model rules provide for other measures of damages, typically damages designed to place a person in the position which would have prevailed in the absence of acting in reliance on something. The particular rules mentioned above in Comment A do not relate to damages for non-performance of an obligation. Nonetheless it is perfectly conceivable that a rule relating to a particular kind of obligation could provide for a special measure of damages. This possibility is left open by the Article.

III.-3:703: Foreseeability

The debtor in an obligation which arises from a contract or other juridical act is liable only for loss which the debtor foresaw or could reasonably be expected to have foreseen at the time when the obligation was incurred as a likely result of the non-performance, unless the non-performance was intentional, reckless or grossly negligent.

COMMENTS

A. Scope of Article

This Article applies only to obligations voluntarily incurred by contract or other juridical act. In such cases the debtor at the time of incurring the obligation has an opportunity to restrict liability in relation to foreseeable losses but not in relation to unforeseeable losses. This consideration does not apply to obligations which arise by operation of law.

The Article also does not apply where the default was intentional, reckless or grossly negligent. In such cases it seems more reasonable to place the risk of a non-foreseeable loss on the debtor rather than on the innocent creditor. A person is reckless if the person knows of an obvious and serious risk of proceeding in a certain way but nonetheless voluntarily proceeds to act without caring whether or not the risk materialises; there is gross negligence if a person is guilty of a profound failure to take such care as is self-evidently required in the circumstances. See Annex 1.

Where the Article does not apply, the normal rules on causation will determine the extent of the debtor's liability.

Not all the laws of the Member States limit damages by a rule of foreseeability; some, for example, use a criterion of "adequate causation". However, the results are usually rather similar to those obtained by employing the foreseeability test, which has been adopted by international conventions such as the CISG (art 74). Cases of intentional, reckless or grossly negligent non-performance are often not expressly excluded from the rule in the national laws, but in practice the courts may well reach this result and the limitation seems a fair one.

B. Foreseeable consequences of failure to perform

The Article sets out the principle by which liability for loss caused by non-performance of a voluntary obligation is limited to what the debtor foresaw or could reasonably be expected to have foreseen, at the time when the obligation was incurred, as the likely consequence of the failure to perform. However, as noted above, the last part of the Article provides a special rule for the case where the default was intentional, reckless or grossly negligent.

Illustration 1

B, a stamp dealer, contracts to buy from S for €10,000 a set of stamps, to be delivered to B on 1st June. S fails to deliver the stamps, which on 1st June have a market value of €12,000. The failure is not, however, intentional, reckless or grossly negligent. Because of S's non-performance of the obligation, B is unable to fulfil a contract to resell the collection to T for €25,000. S, though aware that B required the stamps for resale, was not aware that B would resell the stamps as a

collection. B is entitled to recover as damages the sum of €2,000, being the difference between the market value of the stamps on 1st June and the sale price. S is not liable for the remaining €13,000 of B's loss, which S could not reasonably have foreseen at the time of contracting to sell the stamps to B.

Illustration 2

Company S sells an animal food compound to B for feeding to pigs. B does not tell A for what breed of pigs the food is required. S negligently supplies a batch of the compound which contains a mild toxin known to cause discomfort to pigs but no serious harm. B's pigs are, however, of an unusual breed which is peculiarly sensitive to the toxin and after being fed with the compound many of the pigs die. S is not liable for the loss since it could not reasonably have foreseen it.

C. Exception for breach which is intentional, reckless or grossly negligent

Although in general the debtor is liable only for loss which the debtor foresaw or could reasonably be expected to have foreseen at the time of the contract, the last part of this Article lays down a special rule in cases of intentional or reckless failure in performance or gross negligence. In this case the damages for which the debtor is liable are not limited by the foreseeability rule and the full damage has to be compensated, even if unforeseeable.

Illustration 3

A contracts with B to construct and erect stands for a major exhibition at which leading electronic firms will display their equipment, hiring the stands from B. A week before the exhibition is due to open A demands a substantial increase in the contract sum. B refuses to pay, pointing out that A's failure to complete the remaining stands will not only cost B revenue but expose B to heavy liability to an exhibitor, C, which intended to use the exhibition to launch a major new product. A nevertheless withdraws its workforce, with the result that C's stand is not ready in time and C claims substantial compensation from B. A's breach being intentional and with knowledge of the likely consequences, the court has to award B an indemnity in respect of its liability to C, even though A could not reasonably have foreseen the magnitude of such liability at the time it made its contract with B. The same may be done even if A was not aware of the serious consequences for B of the intentional breach.

III.-3:704: Loss attributable to creditor

The debtor is not liable for loss suffered by the creditor to the extent that the creditor contributed to the non-performance or its effects.

COMMENTS

A. Loss caused by unreasonable action or inaction

This Article embodies the principle that a creditor should not recover damages to the extent that the loss is caused by the creditor's own unreasonable behaviour. It embraces two distinct situations. The first is where the creditor's conduct was a partial cause of the non-performance; the second, where the creditor's conduct, though not in any way responsible for the non-performance itself, exacerbated its loss-producing effects. A third situation, where the loss resulting from the non-performance could have been reduced or extinguished by appropriate steps in mitigation, is covered by the next Article.

B. Conduct contributing to the non-performance

To the extent that the creditor contributed to the non-performance by act or omission the creditor cannot recover the resulting loss. This may be regarded as a particular application of the general rule set out in III.-3:101 (Remedies available) paragraph (3).

Illustration 1

B orders a computer system from S which is to be specially designed to allow B to send to prospective property buyers details of houses coming on to the market which appear to meet their requirements. The computer system fails to operate properly, due partly to a design defect and partly to the fact that B's instructions to S were incomplete. B's loss is irrecoverable to the extent that it results from B's own inadequate instructions.

C. Conduct contributing to the loss-producing effects of non-performance

Where the creditor, though not in any way responsible for the non-performance, exacerbates its adverse effects damages cannot be recovered for the additional loss which results.

Illustration 2

A leases a computer which under the terms of the contract is to be ready for use in England where the voltage is 240v. The computer supplied is capable of operating on various voltages and, contrary to the terms of the contract, is actually set for 110v. A prominent sign pasted on the screen warns the user to check the voltage setting before use. A ignores this and switches on without checking. The computer is extensively damaged and repairs will cost A £1,500. The court may take the view that the loss was at least half A's fault and award only £750 damages.

III.-3:705: Reduction of loss

(1) The debtor is not liable for loss suffered by the creditor to the extent that the creditor could have reduced the loss by taking reasonable steps.

(2) The creditor is entitled to recover any expenses reasonably incurred in attempting to reduce the loss.

COMMENTS

A. Failure to mitigate loss

Even where the creditor has not contributed either to the non-performance or to its effects, the creditor cannot recover for loss which would have been avoided if the creditor had taken reasonable steps to do so. The failure to mitigate loss may arise either because the creditor incurs unnecessary or unreasonable expenditure or because the creditor fails to take reasonable steps which would result in reduction of loss or in offsetting gains.

Illustration 1

B buys an old car from S for €750. S warrants that the car is in good running order. B discovers that it will cost €1,500 to put the car into good running order, and has this work done although similar cars in good condition are available for €800. B's damages will be limited to €800; the extra amount represents an expenditure which was quite disproportionate to the value of the car as repaired (The result might be different if there were some good reason for B to have repairs done, e.g., the car was unique in that it had once belonged to General de Gaulle).

Illustration 2

C hires a camper van for a holiday in Portugal. When C comes to collect the camper van, the car hire company says that it has made a mistake in bookings and no van is available from it, but it has managed to find another company which has a van available at a higher price. Even if C unreasonably ignores this and abandons the holiday, damages should be limited to the loss which would have been suffered if C had acted reasonably in taking the substitute van, namely the difference in cost between the vans and compensation for inconvenience in having to collect the replacement.

The creditor will not necessarily be expected to take steps to mitigate the loss immediately on learning of the debtor's non-performance; the outcome will depend on whether the creditor's actions are reasonable in the circumstances.

Illustration 3

O engages B, a builder, to come within 24 hours to repair the roof of O's house, which is leaking and causing damage. B does not come within the 24 hours but assures O that the work will be done the next day. It is reasonable for O to wait until the day after before calling in another builder, and O may claim damages

resulting from this period of delay; but it may not be reasonable to wait any longer and if O does so O may not recover damages for the resulting additional loss.

The creditor is only expected to take action which is reasonable, or to refrain from action which is unreasonable, in the circumstances. The creditor need not, for example, act in a disreputable way just to reduce the debtor's liability.

Illustration 4

D buys goods from E in order to resell them to F. The goods supplied by E are not of proper quality. Although under the terms of its contract with F, D could require F to take the goods without a price reduction, this would be unreasonable in the light of their long-standing business relationship and D gives F a reduction of price. D may recover the amount by which it reduced the price as damages from E.

The principle applies also when there is anticipated non-performance, e.g., when the debtor has announced that the obligation will not be performed when the time comes. The creditor should not incur further expenditure needlessly and should take steps to reduce the loss.

Illustration 5

K contracts to build a yacht to L's special design. L has a sudden change of mind and repudiates the contract. If K has done little work on the yacht and would not be able to find a ready buyer for such a unique design of boat, it is reasonable to expect K to stop work; K may recover the cost of the work done to date and the loss of anticipated profit. If, on the other hand, K has done most of the work and can find another buyer at a reasonable price, then K may be expected to complete the boat and resell it. K will be entitled to damages of the difference between the original contract price and the resale price, plus the incidental costs of arranging the resale.

C. Expenses incurred in mitigating loss

Frequently the creditor will have to incur some further expenditure in order to mitigate the loss. This incidental expenditure is also recoverable provided it is reasonable.

Illustration 6

X agrees to buy Y's chalet, which Y had advertised widely. Later X repudiates the contract. Y decides to make a cover transaction. In order to resell the house she has to advertise it again. She is entitled to the reasonable cost of the further advertising as well as to the difference between the price X had agreed to pay and the price for which the chalet was ultimately sold.

D. Reasonable attempts to mitigate which in fact increase the loss

Sometimes a party may take what at the time appears to be a reasonable step to reduce the loss but in fact increases it. The full loss suffered is recoverable.

Illustration 7

G enters a long term supply contract to buy oil from H; deliveries are to commence in six months' time. Three months later oil prices rise rapidly because of a threatened war in the Gulf and H repudiates the contract. G quickly terminates and enters a substitute contract with J at the price then being quoted for delivery three months later. By the time the date for delivery comes the threat of war has receded and G could have bought the oil for the original contract price. G acted reasonably in entering the substitute contract and is entitled to damages based on the difference between the original contract price and the price paid to J.

E. Loss reduced by steps going beyond what could reasonably be expected

Sometimes a creditor will take a step which reduces the loss but which goes beyond what could reasonably be expected. The reduction in loss will still be taken into account, as the creditor is entitled only to damages for actual loss.

III.-3:706: Substitute transaction

A creditor who has terminated a contractual relationship in whole or in part under Section 5 and has made a substitute transaction within a reasonable time and in a reasonable manner may, in so far as entitled to damages, recover the difference between the price and the substitute transaction price as well as damages for any further loss.

COMMENTS

A. Cover transactions

It is often appropriate to measure the creditor's loss by the cost of procuring a substitute performance. Where the creditor has terminated for fundamental non-performance and has made a reasonable cover transaction, this Article provides that the difference between the price and the cover price is recoverable. The debtor may also be liable for any further loss which the creditor has suffered, e.g. the cost of arranging a cover transaction.

Illustration 1

O agrees to allow H the use of its art gallery for an exhibition at a fee of €1,000. Shortly before the exhibition is to take place O informs H that the gallery will not after all be available. H terminates and succeeds in obtaining the use of a nearby gallery of similar size and quality for a fee of €1,500. She is entitled to damages of €500 representing the amount by which the cost of the cover transaction exceeds the contract price, as well as damages for any reasonable expenses (e.g. changing the address on leaflets and posters).

B. Alternative transaction must be a reasonable substitute

The creditor cannot recover the difference between the price due under the terminated obligation and the alternative transaction price if the alternative transaction is so different from the original transaction in value or kind as not to be a reasonable substitute.

Illustration 2

O supplies a small car on hire to H for three weeks at a rent of €1000 a week. The car breaks down at the end of the first week while H is on holiday, and as no other small car is available she terminates the contractual relationship with O and hires a large luxury car from another firm for the remaining two weeks at a rent of €5000 a week. H's damages for extra rental charges will be restricted to the additional cost, if any, of hiring the nearest available equivalent of the original car in size and value.

C. Creditor must be entitled to damages

This Article is not intended to provide an independent ground of liability which overrides the normal rules on damages. If the creditor is not entitled to damages, or is entitled to only restricted damages because for example of a contractual limitation on the amount recoverable, then these restrictions cannot be avoided simply by making a cover transaction.

Illustration 3

A contract provides that on termination by either party for any reason the other will not be liable for any loss caused by non-performance of obligations falling due for performance after the time when termination takes effect. This provision cannot be avoided simply by the making of a cover transaction.

III.-3:707: Current price

Where the creditor has terminated a contractual relationship in whole or in part under Section 5 and has not made a substitute transaction but there is a current price for the performance, the creditor may, in so far as entitled to damages, recover the difference between the contract price and the price current at the time of termination as well as damages for any further loss.

COMMENTS

A. Damages measured by current price

In so far as the cost of substitute performance fairly measures the shortfall in the value of the debtor's performance it is recoverable as such whether or not the creditor actually incurs the expenditure.

Illustration

S agrees to sell 50 tons of coffee to company B at €1,800 a ton for delivery on 1st July. S fails to deliver the coffee. In the circumstances this is a fundamental non-performance. B terminates. The market price on 1st July is €2,000 a ton. B is entitled to damages of €10,000 (i.e. 50 x 200 = 10,000) even if it does not make a substitute purchase on the market.

Again, as in the preceding Article, it should be noted that this rule presupposes that the creditor is entitled to damages. It is a way of quantifying damages, not an independent ground of liability.

This Article represents a commonly accepted principle, although the formulations sometimes differ as to the date by reference to which the current price should be calculated

III.–3:708: Delay in payment of money

(1) If payment of a sum of money is delayed, whether or not the non-performance is excused, the creditor is entitled to interest on that sum from the time when payment is due to the time of payment at the average commercial bank short-term lending rate to prime borrowers prevailing for the contractual currency of payment at the place where payment is due.

(2) The creditor may in addition recover damages for any further loss.

COMMENTS

A. Purposes

This Article provides for interest and damages on failure to pay money by the date at which payment is due. This is the result reached in the laws of the Member States, though there are significant differences in detail.

B. Interest

Paragraph (1) confers a general right to interest when payment of a sum of money is delayed. The question of interest on interest, or capitalisation of interest, is dealt with in the next Article and so, by implication, is not covered here.

Interest is not a species of ordinary damages. Therefore the general rules on damages do not apply. Interest is owed whether or not non-payment is excused. Also, the creditor is entitled to it without regard to any question whether the creditor has taken reasonable steps to mitigate the loss.

The rate of interest is fixed by reference to the average commercial bank short-term lending rate. This rate applies also in the case of a long delay of payment since the creditor at the due date cannot know how long the debtor will delay payment. Since interest rates differ, the lending rate for the currency of payment (III.–2:109 (Currency of payment)) at the due place of payment (III.–2:101 (Place of performance)) has been selected because this is the best yardstick for assessing the creditor's loss. Unless otherwise agreed, interest is to be paid in the same currency and at the same place as the principal sum. The parties are free to exclude or modify paragraph (1) e.g. by fixing the rate of default interest and/or its currency in their contract.

C. Additional damages

Paragraph (2) makes it clear that the creditor's remedy for non-payment or delay in payment is not limited to interest. It extends to additional and other loss recoverable within the limits laid down by the general provisions on damages. This might include, for example, loss of profit on a transaction which the creditor would have concluded with a third party had the money been paid when due; a fall in the internal value of the money, through inflation, between the due date and the actual date of payment, so far as this fall is not compensated by interest under paragraph (1); and, where the money of payment is not the money of account, loss on exchange. However, in this last case the creditor has the option of proceeding instead under III.–2:109 (Currency of payment) paragraph (3).

Illustration 1

A agrees to pay B €50,000 if B will vacate A's property and find alternative accommodation. B moves out of the property but A fails to pay the agreed sum. In consequence B, who as A knew intended to use the payment to buy a house from C, has to negotiate with C to leave part of the purchase price outstanding on mortgage at interest. B is entitled to sue A for the interest and legal costs reasonably incurred.

Illustration 2

C agrees to lend €200,000 to D to enable D to purchase a business at a price equal to that sum from E. Under the contract of sale, the terms of which are known to C, time of payment is fundamental and any delay entitles E to terminate. At the last moment C refuses to advance the money and D is unable to obtain alternative funds in time. E terminates and sells his business to F for €300,000, its true value. D is entitled to damages from C for the loss of the contractual rights.

Illustration 3

S in London agrees to sell goods to B in Hamburg at a price of US\$ 100,000 payable in London 28 days after shipment. The goods are duly shipped to B, who is three months late in paying the price. During this period the value of the US dollar in relation to the pound sterling (the currency in which S normally conducts his business) depreciates by 20 per cent. Assuming that these consequences of delay in payment could reasonably have been foreseen by B at the time of the contract, S is entitled to recover US\$ 20,000 damages from B, in addition to interest, for the loss on exchange.

III.–3:709: When interest to be added to capital

(1) Interest payable according to the preceding Article is added to the outstanding capital every 12 months.

(2) Paragraph (1) of this Article does not apply if the parties have provided for interest upon delay in payment.

COMMENTS

A. Notion

Simple interest (whether contractual or legal) does not affect the capital upon which it is calculated: the capital remains unaltered. If, however, a capitalisation of interest (or compound interest) has been agreed or is imposed by law or custom, the interest which has fallen due during the agreed period (rest period) and has remained unpaid, is added to the capital. Therefore, during the second rest period, since more capital is bearing interest, the amount of interest will increase, and so on.

Illustration 1

Bank B has extended to L a credit of €10,000 due to be repaid on 31 December 2000. No payment is made. If the parties had not agreed upon delay interest, Article 9:508(1) applies: it is assumed that the interest rate according to this provision is 10% per year. Consequently, on 1 January 2002, an unpaid delay interest of €1000 will be added to the capital of €10,000, increasing it to €11,000; and on 1 January 2003, an amount of €1100 will be added, increasing the capital to €12,100; etc.

B. Scope of application

The Article applies as a remedy for delayed payment of interest. But the capitalisation of interest may, of course, be agreed upon for contractual obligations in the absence of any question of delayed payment. An important example is the capitalisation of interest on positive or negative balances of a current account. Contractual arrangements of this type are not affected by the present rule.

In the laws of many Member States, compound interest is payable only when the parties have so agreed or in other limited circumstances. However it is generally acknowledged that when there has been a delay in the payment of money, an award of simple interest to the creditor will seldom be adequate compensation. The delay will normally cause the creditor a loss in one of two ways. If the creditor needs the money for other purposes, it will have to borrow to cover the temporary shortfall, and it will almost certainly have to pay compound rates to the lender. If it did not have an immediate need for the money, it would have been able to invest it at compound rates. Therefore it seems sensible to adopt a general rule that default interest may be compounded at an appropriate interval.

C. Justifications

The Article confers upon the creditor of an interest bearing monetary debt, after the debtor has failed to pay interest which has fallen due, a right to capitalisation of interest. This is justified by the fact that interest earned by the creditor of a monetary obligation is an asset. Delay in its payment deprives the creditor of a due benefit as much as delay in the payment of the capital itself. Moreover, delay in payment often has a highly detrimental effect upon creditors, especially smaller business enterprises which may be driven into bankruptcy. There is therefore, both at Community level and in several member states, a clear tendency to provide a sanction for late payments. The capitalisation of interest is an effective sanction because of its gradually increasing effect.

D. Party agreement on delay interest

The Article provides, in accordance with general principle, that the general rule on the capitalisation of interest does not apply where the parties have agreed, explicitly or implicitly, upon the payment of delay interest. The fact that the parties have addressed themselves to the question of interest means that it is up to them to provide for capitalisation if they so wish.

Illustration 2

The parties agree on interest of 7 % p.a. “until payment”. This clause covers both credit interest and delay interest. The capitalisation of the delay interest is excluded by the second sentence of the Article.

E. Computation of time

In order to determine the beginning of the rest period of twelve months, one has to look to the terms regulating the obligation to pay interest. Unless the parties have agreed upon that time, it must be determined according to applicable legal rules. Reference may be made to III.-2:102 (Time of performance) and to III.-3:708 (Delay in payment of money). So far as other aspects of the computation of time are concerned reference may be made to Annex 2.

F. Relation to damages

The obligation to pay interest upon delay in payment is functionally equivalent to an obligation to pay damages. The interest can be regarded as a form of abstract damages, although it is not ordinary damages. (See Comment B to the preceding Article.) The capitalisation of interest has the advantage of extending this remedy. Consequently, the scope of application of III.-3:708 (Delay in payment of money) paragraph (2) (additional damages for loss caused by delay in payment of money, so far as not covered by interest) will be further narrowed since the creditor need not and cannot claim damages for any loss which is already compensated by the payment of interest.

However, the creditor is entitled to any additional damages not so compensated. But the amount of such damages and the sometimes difficult task of proving them will, generally speaking, be much restricted if and in so far as capitalisation of interest is allowed.

G. Consumer protection

The national rules on consumer protection, especially on consumer credit, such as those based upon the relevant EC-Directive of 1986, have, of course, preference. The Directive itself does not deal with capitalisation of interest.

III.-3:710: Stipulated payment for non-performance

(1) Where the terms regulating an obligation provide that a debtor who fails to perform the obligation is to pay a specified sum to the creditor for such non-performance, the creditor is entitled to that sum irrespective of the actual loss.

(2) However, despite any provision to the contrary, the sum so specified in a contract or other juridical act may be reduced to a reasonable amount where it is grossly excessive in relation to the loss resulting from the non-performance and the other circumstances.

COMMENTS

A. Stipulation as to payment for non-performance binding

It is common for the parties to a contract to specify a sum to be paid for non-performance, with a view to avoiding the difficulty, delay and expense involved in proving the amount of loss in a claim for unliquidated damages. Such a term may also prompt the debtor to perform voluntarily, when the penalty is heavy. To perform is then cheaper than paying the penalty. Paragraph (1) gives effect to such a provision, so that except as provided by paragraph (2) the court must disregard the loss actually suffered by the creditor and must award neither more nor less than the sum fixed by the contract. It follows that the creditor is under no obligation to prove any loss. The terms regulating a non-contractual obligation may also provide for a stipulated payment to be made by the debtor in the event of non-performance.

Illustration 1

B agrees to build a house for A and to complete it by April 1st. The contract provides that for every week's delay in completion B is to pay A the sum of € 200. B completes the house on April 29th. A is entitled to €800 as agreed damages, whether his actual loss (e.g., the cost of renting alternative accommodation during the four week period of delay) is greater or less than that sum.

Illustration 2

A agrees to sell a house to B and obtains a deposit of 20 per cent of the price to secure B's performance of the contract. B refuses to complete the transaction. A may forfeit the deposit.

Where, however, the contract specifies merely the minimum sum payable by the debtor, the creditor may recover a higher figure if the loss exceeds the minimum sum. In this case the creditor may elect to sue for damages at large instead of invoking the provision for agreed damages.

The treatment of “agreed damages” clauses varies from one legal system to another. Some systems admit them provided that the damages are not substantially greater than the loss that a non-performance is likely to cause, and strike down stipulations for substantially more than that amount as unenforceable “penalties”. Others accept that the parties may agree on a penal sum but give the court power to reduce it in some circumstances. As it seems generally to be agreed that there is nothing wrong with the parties agreeing a penalty for non-performance provided that they are fully aware of what they are doing and it does not operate unfairly, the rules take the approach that penalties may be agreed but the court should have power to reduce them when necessary.

B. Court's power to reduce grossly excessive stipulations

To allow the parties to a contract complete freedom to fix the sum payable for non-performance may lead to abuse. If there is a gross disparity between the specified sum and the actual loss suffered by the creditor the court may reduce the sum even if at the time of the contract it seemed reasonable. Since the purpose is to control only those stipulations which are abusive in their effect, the court's reducing power is exercisable only where it is clear that the stipulated sum substantially exceeds the actual loss. This power of the court has a limit: it should respect the intention of the parties to deter default and therefore should not reduce the award to the actual loss. The court has to fix an intermediate figure.

Illustration 3

A supplies equipment to B on lease for five years at a rent of €50,000 a year. The agreement provides that in the event of termination because of default by B in performing its obligations B is to pay A by way of agreed damages a sum equal to 80% of the future rentals. In the light of circumstances existing at the time of the contract this stipulation is not unreasonable. After a year A terminates because of B's default in payment. As the result of an unexpected increase in the demand for the type of equipment in question A, having secured the return of the equipment, is able to re-let it at twice the rent payable under the original lease. The court may reduce the agreed damages payable so as to take account of this fact.

The power to reduce the stipulated sum also applies to sums specified in unilateral juridical acts, where similar considerations apply. It does not, however, apply to sums stipulated by rules of law. It would be inappropriate to allow courts to modify such sums if the relevant rule of law has not provided for the possibility of such modification.

C. "Excessive" sum

In deciding whether the stipulated sum is excessive the court should have regard to the relationship between that sum and the loss actually suffered by the creditor, as opposed to the loss legally recoverable taking account of the foreseeability principle. On the other hand, the computation of actual loss should take into account that element of the loss which has been caused by the unreasonable behaviour of the creditor, e.g. in failing to take reasonable steps in mitigation of loss.

D. Genuine options not covered

The Article does not apply to a genuine option to pay a sum of money instead of performing a non-monetary obligation, since the Article deals with non-performance, not with alternative obligations or methods of performance (forfait clause, "*clause de dédit*").

III.-3:711: Currency by which damages to be measured

Damages are to be measured by the currency which most appropriately reflects the creditor's loss.

COMMENTS

A. General remarks

Exchange rates between individual currencies are subject to more or less heavy fluctuations. Consequently, the question in which currency damages have to be measured is relevant. Over or under-compensation must be avoided by fixing damages measured by reference to the correct currency. This provision fixes the currency in which damages are to be measured. Technically speaking, the currency of account for damages is laid down.

By contrast, III.-2:109 (Currency of payment) deals in a general way with the currency of payment. If damages (or interest) have arisen in a currency other than the local currency of the place of payment, any conversion into the latter currency is governed by that Article.

Measurement of damages by reference to the most appropriate currency is not yet accepted in all Member States but it seems to be the modern tendency

B. Purpose

Since damages have the purpose of putting the creditor into the same position as if there had been performance (III.-3:702 (General measure of damages)) they have to be expressed in the currency which is most appropriate to achieve that result. Damages therefore should not automatically be measured in the local currency of the court; in most countries judgments in foreign currency are allowed. Even if they are not allowed, but the damages had arisen in a foreign currency and are measured in that currency, the conversion into the local currency at current exchange rates will lead to an appropriate result.

C. Explanation

In view of the vast variety of the facts of international commercial intercourse, the currency of the damages which is most appropriate to compensate the creditor cannot generally be determined with precision. In many cases it will be the contractual currency of account. But where this is not the currency which the creditor had to utilize in order to make good the loss, e.g. by making a cover transaction, the latter currency may be more appropriate, especially if the creditor utilizes the currency of the creditor's home country for this purpose. Generally this will be the currency in which the creditor makes business deals.

Illustration 1

Japanese machine manufacturer C has made a contract for delivery of certain machinery with French importer F. F wrongfully cancels the contract. C's damages have arisen in Japanese yen.

However, the factors may be different.

Illustration 2

As in Illustration 1, but C is an internationally active company stipulating that payments for its export sales are to be made on a US-Dollar bank account in New York. C's lost profits are to be calculated in US dollars.

It is also possible for loss to arise in several currencies.

D. Derived claims

Where a party is entitled to interest, such interest is usually measured and payable in the same currency as the principal. This is so in particular where the interest is expressed as a percentage of the principal sum.

The same is true if the amount of damages is fixed in a contract as a percentage of the price.

Illustration 3

In a construction contract, the parties have agreed on a penalty of 1% of the price for every week of default in completion of the construction, the price being expressed in euros. The penalty will be due in euros as well.

E. Autonomy of the parties

Of course, the parties to a contract are free to fix the currency of damages or interest by reference to any currency they like.

CHAPTER 4: PLURALITY OF DEBTORS AND CREDITORS

Section 1: Plurality of debtors

III.-4:101: Scope of Section

This Section applies where two or more debtors are bound to perform one obligation.

COMMENTS

Section 1 of this Chapter is not intended to cover all cases of plurality of debtors. It deals only with those cases which call for regulation because of their practical importance or theoretical difficulty. So, it does not cover, for example, multiple obligations arising from a number of different contracts concluded in order to meet a single objective, such as orders given by a trader to several suppliers to satisfy the needs of the trader's customers. The fact that several debtors are bound by parallel obligations arising from distinct contracts does not affect the legal nature of each debt. The situation is the same when distinct obligations arise under the same contract. The problems which require resolution arise where there is one obligation with two or more co-debtors and in certain specific cases where two or more debtors are liable under closely related obligations – for example, where they are liable for the same damage. The Article makes it clear that the scope of the Section is confined to such cases. It follows that in subsequent Articles in the Section references to the debtors must be read as references to co-debtors who are within the scope of the Section.

It should be noted that in the case of a contractual obligation the debtors' liability need not arise from one contract. It could, and often does, happen that A is bound under one contract to perform an obligation and B then, by another contract, undertakes to perform the same obligation as a co-debtor. If this is really a security obligation then Book IVD on personal securities will be the primary source of rules on the rights and obligations of the parties. The ordinary co-debtorship rules of the present Chapter will apply so far as not inconsistent with the personal security rules. This result is achieved by IV.G.-1:106 (Co-debtorship for security purposes) which provides that "A co-debtorship for security purposes is subject to the rules of Parts 1 and 4 and, subsidiarily, to the rules on plurality of debtors".

III.-4:102: Solidary, divided and joint obligations

(1) An obligation is solidary when each debtor is bound to perform the obligation in full and the creditor may require performance from any of them until full performance has been received.

(2) An obligation is divided when each debtor is bound to perform only part of the obligation and the creditor may claim from each debtor only performance of that debtor's part.

(3) An obligation is joint when the debtors are bound to perform the obligation together and the creditor may require performance only from all of them together.

COMMENTS

A. General remarks

The Article deals with three types of plural obligations - solidary obligations, divided obligations and joint obligations. Solidary obligations and divided obligations are known in all legal systems, with variations in terminology and detail, but not all laws expressly recognise joint obligations. Legal systems which do not recognise joint obligations sometimes have a category of "indivisible obligations" which covers much of the same ground. Some systems, such as French law, give indivisibility a special role in the law of succession: a debt which is indivisible, in contrast to a solidary debt, is not divided among the heirs. It goes without saying that the fact that a contract is governed by these rules does not prevent the parties, to the extent permitted by the law of succession, from supplementing a solidarity clause, covered by these rules, with a clause of indivisibility for the purpose of obtaining particular effects in relation to succession.

B. Solidary obligations

Paragraph (1) of the Article defines solidary obligations, which are the plural obligations most frequently encountered in practice. The definition reflects their characteristic features. The creditor can claim the whole performance from any one of the debtors, without being obliged to involve all the debtors or even warn them. The debtor against whom the claim is made cannot compel the creditor to divide the claim.

Illustration 1

A lends €10,000 to B and C. The contract contains a clause of solidarity. A can claim repayment of the loan from B or C according to choice.

Having the option of claiming the whole performance from any of the debtors, the creditor is in a position, if that debtor fails to perform, to put into operation right away the various remedies for non-performance provided by these rules. So, the creditor can terminate the contractual relationship in whole or in part if the selected debtor's non-performance of a contractual obligation is fundamental. Similarly, the creditor can withhold performance of reciprocal obligations so long as the selected debtor has not performed or tendered performance. However, the other debtors can perform the obligation in order to put a stop to the termination or the withholding of performance. As this is a case where the other debtors have a legitimate interest in performance the creditor cannot refuse their performance.

C. Divided obligations

Paragraph (2) defines divided obligations. They are distinguished from solidary obligations in that each of the debtors is liable for only part of the performance due. The debtors have separate liability for their own shares. So the creditor cannot claim the whole performance from one of the debtors but must necessarily divide the claim.

Illustration 2

A lends €10,000 to B and C. The contract provides that B must repay €8000 and C €2000. A can claim only the agreed part from each.

The effects of non-performance by one of the debtors on the operation of the creditor's right to withhold performance of reciprocal obligations or to terminate for fundamental non-performance are very different in this case. Non-performance by one of the debtors leads, in principle, only to partial termination. Where a contract gives rise to divided obligations the situation falls within the rules on termination for fundamental non-performance in relation to obligations which are to be performed in separate parts or are otherwise divisible. Similarly, the creditor may not, as a general rule, withhold performance except partially. Where, however, the performance due by the creditor is indivisible, the debtors having only a joint right, the withholding will necessarily be total.

Illustration 3

Three farmers, A, B and C, order twelve sacks of winter wheat seed from a producer, D, for a price of €9000. The contract provides that each buyer is liable only for a one-third share (€3000). A becomes insolvent. D could terminate only the obligations relating to A's share.

Illustration 4

Two farmers, A and B, order an agricultural machine from a manufacturer, C. The contract provides that the two buyers are to be under separate obligations for the price, payable on delivery. A and B having a joint right against C for delivery of the machine (see Article III - 5:202(3)), C can withhold delivery so long as A does not pay A's part of the price.

D. Joint obligations

Paragraph (3) defines joint obligations, which are characterised by the unitary nature of the obligation binding the several debtors. Joint obligations are more rare in practice. They relate to performances which by their nature have to be rendered in common by several debtors, bound to the creditor by a single contract.

A joint obligation is distinguished from a solidary obligation in that the creditor in a joint obligation can take action only against all the debtors together. It is distinguished from a divided obligation in that the performance due by each debtor is not limited to an independent performance of that debtor's own share of the obligation. The joint obligation is not simply a combination of isolated parts of an obligation. Each of the debtors is obliged to collaborate with the others to provide the common performance.

Illustration 5

A recording company enters into a single contract with several musicians who are to play a symphony with a view to making a record. In the event of non-performance, the recording company will have to take action against all the musicians.

Illustration 6

The owners of a piece of ground wish to have a house built. If they approach contractors in different trades, asking for a single performance (namely the construction of the house), and if the co-contractors agree to work together to achieve that result, the obligation will be a joint one.

The non-performance of one of the debtors in a joint obligation necessarily has an effect on the obligation as a whole. It follows that the creditor can terminate for fundamental non-performance even if the non-performance is imputable to only one of the debtors. Similarly, the creditor can withhold reciprocal performance totally, even if the failure to give or tender the debtors' performance emanates from only one of the debtors.

III.-4:103: When different types of obligation arise

(1) Whether an obligation is solidary, divided or joint depends on the terms regulating the obligation.

(2) The default rule is that the liability of two or more debtors to perform the same obligation is solidary. This applies in particular where two or more persons are liable for the same damage.

(3) Incidental differences in the debtors' liabilities do not prevent solidarity.

COMMENTS

A. General

This article sets out the situations where the different types of plural obligation arise. The basic rule is that the character of an obligation depends on the terms of the contract or other juridical act or rule of law giving rise to the obligation.

B. Default rule of solidarity

Often the terms regulating the obligation will not say whether it is solidary, divided or joint. In some cases that will not be a problem; the nature of the obligation or the circumstances of the case may provide an answer. It will almost always be obvious from the nature of the obligation or the circumstances when an obligation is joint. For example, a contract with 28 street entertainers for the construction of a human pyramid containing them all gives rise by its very nature to a joint obligation. Sometimes the circumstances will indicate that an obligation is to be a divided one.

Illustration 1

A and B order, by one contract, a fixed quantity of fuel to be delivered to different tanks. The reason for the combined order is to benefit from a reduction in price. Their obligation to pay will be a divided one if the contract provides that each is to be liable for only half the price. The same result will follow if the parties have agreed that the supplier will send separate bills to A and B, that being a tacit indication that the parties wished to provide for a divided obligation.

In many cases, however, it will not be clear whether an obligation is solidary or divided. If A and B bind themselves to pay X €1000 and it is obvious that X is to receive no more than €1000 it is not clear whether the obligation is solidary or divided. It is necessary to have a default rule.

The laws of the Member States have different approaches on this question. However, the solidary obligation is clearly better from the creditor's point of view and can perhaps be said to be the natural interpretation of provisions providing for plural liability for one obligation. If A and B say "We oblige ourselves to pay X €1000 but only €1000 in total is due" then that can reasonably be read as meaning that each is bound to pay the full amount provided that the total payable to X is only €1000. If they want to provide that each is liable for a part then they should say so. The same applies, although perhaps with less force, to obligations arising by operation of law. Paragraph (2) therefore provides for a default rule of solidary liability when there are two or more debtors but one single obligation. It is justified because the natural implication from the fact that A and B are both bound, without any qualification, to perform the same obligation is that each is bound to perform in full if called upon to do so.

Illustration 2

Several friends conclude a contract with a landlord for the rent of a holiday villa in the south of France. The landlord can claim the whole rent from one of the tenants under the rule in paragraph (2).

Illustration 3

Several students come across a holiday chalet in the mountains and occupy it for two weeks without permission. They are liable under the law on unjustified enrichment to pay an equivalent of rent. Their liability will be solidary.

C. Solidarity when several persons liable for same damage

Paragraph (2) provides, in order to protect the victim of damage caused by several people, that the obligation of reparation arising out of damage is solidary. The victim can therefore claim reparation for the harm from any one of those responsible for it. This solidarity applies whatever the nature of the responsibility in question. One of those responsible could be bound contractually, the other non-contractually. (On recourse between the co-debtors, see III.-4:107 (Recourse between solidary debtors))

Illustration 4

A, an employer, and B, an employee, are bound by a contract of employment containing a lawful restrictive covenant. C employs B with full knowledge that this violates the contract. B and C will be solidarily liable to A. B is contractually liable for breach of the restrictive covenant and C is liable for wrongfully inducing the breach of contract.

D. Incidental differences in liabilities

Paragraph (3) deals with the case where the conditions required for solidarity are fulfilled but the liability of one or more of the debtors is subject to a qualification, such as a condition or a time limit. The existence of this qualification does not prevent solidarity. The same rule applies when the liability of one of the debtors, but not others, is backed by a security.

Illustration 5

A, B and C borrow funds to buy a building from D. B's liability is subject to the condition that a purchaser can be found for B's present house within a year. This condition affecting B's liability does not prevent the debt of A, B and C from being solidary. Similarly, the solidary character of the obligation is not excluded if A's debt is secured and the debts of B and C are unsecured.

III.–4:104: Liability under divided obligations

Debtors bound by a divided obligation are liable in equal shares.

COMMENTS

This Article provides a default rule which comes into play when the share of a divided obligation for which each debtor is liable cannot be otherwise established. The rule in III.–4:103 (When different types of obligations arise) paragraph (2) makes divided obligations more rare, which limits the scope of the present rule in practice.

Illustration

A and B undertake to repay a sum of €10,000 to C. The contract contains a clause excluding solidarity between the debtors. A and B will each have to repay €5000.

III.–4:105: Joint obligations: special rule when money claimed for non-performance

Notwithstanding III.–4:102 (Solidary, divided and joint obligations) paragraph (3), when money is claimed for non-performance of a joint obligation, the debtors have solidary liability for payment to the creditor.

COMMENTS

This provision states clearly the principle (found in some laws) that the debtors of a joint obligation have, in any case when money is claimed for total or partial non-performance, a solidary responsibility towards the creditor. It follows that the creditor can claim damages from any one of the debtors. Two considerations justify this rule. First, it is an extension of the principle of the joint obligation. The debtors being liable collectively, it is logical that they should assume full responsibility in the event of non-performance due to the acts of one of them. Secondly, the obligation to pay damages, unlike the primary obligation to perform, is divided since it consists of a right to a sum of money. It is therefore capable of being satisfied by one of the debtors alone. It follows that each debtor should be held liable for the whole.

Debtors who performed their part or who were prepared to do so will often have remedies for non-performance of contractual obligations against the debtor who was responsible for the non-performance, at least if this debtor is not excused from performing. This will enable them to claim damages to cover the whole of the loss which they have suffered. In certain cases the damages could exceed the sum which the non-performing debtor was due to pay to the creditor.

Illustration 1

A contracts with B, a firm of masons and plumbers, and C, a carpenter, for the construction of a country cottage. B and C undertake a joint obligation to A of collective performance and corresponding obligations to each other. B does its work but C does not. In any proceedings by A for damages, B cannot avail itself of the fact that it has done its part of the work. On the other hand, B can avail itself of that fact in the context of its remedies against C.

Illustration 2

A recording company enters into a single contract with several musicians who are to play a symphony with a view to making a record. This is a joint obligation. The musicians also incur mutual contractual obligations to each other. One of the musicians does not turn up. As the recording cannot proceed without all the musicians being present, those who are present and ready to perform on the agreed day cannot plead, in any subsequent action against them by the creditor, that they were ready to play. But they will be able to found on that fact in the context of an action for damages brought by them against the musician who failed to turn up.

III.—4:106: Apportionment between solidary debtors

(1) As between themselves, solidary debtors are liable in equal shares.

(2) If two or more debtors have solidary liability for the same damage, their share of liability as between themselves is equal unless different shares of liability are more

appropriate having regard to all the circumstances of the case and in particular to fault or to the extent to which a source of danger for which one of them was responsible contributed to the occurrence or extent of the damage.

COMMENTS

A. Default rule of equality

In providing a default rule of equal sharing, paragraph (1) adopts a natural and logical rule in line with III.–4:104 (Liability under divided obligations).

Illustration 1

A lends €10,000 to B and C. The contract contains a clause of solidarity. If B has paid the €10,000 to the creditor, B will be able to reclaim €5000 from C.

The rule of equal sharing is laid down only as a general rule. Unequal sharing may result from an express or implied provision of the contract or other juridical act or from the rule of law regulating the obligation .

Illustration 2

A and B order from C, by a contract including a clause of solidarity, a fixed quantity of fuel to be delivered into two tanks of different volume. 10,000 litres are to be delivered to A and 5000 to B. C claims payment from A who pays the whole amount. A will have a right of recourse against B but there is in the circumstances an implied provision of the contract that this will be only for the price of 5000 litres.

Illustration 3

D lends €60,000 to A, B and C who are made solidarily liable. A is to receive €30,000. B and C are to receive €15,000 each. A pays the whole amount and can reclaim a share from B and C but again there is in the circumstances an implied provision of the contract that A can reclaim from each of B and C only the amount of their part of the loan, namely €15,000, and not €20,000.

B. Rule for cases of damage

Paragraph (2) contains a special rule for cases of solidary liability resulting from causing the same damage, a matter . The starting point is equal liability as between the solidary debtors but this applies only if another method of sharing is not more appropriate in the circumstances having regard in particular to fault or to the extent to which a source of danger for which one of them was responsible contributed to the occurrence or extent of the damage.

Illustration 4

Three companies are liable for loss caused to another company by unfair competition consisting of the release of products on to the market. The three companies are not equally at fault. They submit their dispute to arbitration. The

arbitrator could apportion the liability between them according to the degree of seriousness of their respective wrongdoing.

III.-4:107: Recourse between solidary debtors

(1) A solidary debtor who has performed more than that debtor's share may claim the excess from any of the other debtors to the extent of each debtor's unperformed share, together with a share of any costs reasonably incurred.

(2) A solidary debtor to whom paragraph (1) applies may also, subject to any prior right and interest of the creditor, exercise the rights and actions of the creditor, including any supporting security rights, to recover the excess from any of the other debtors to the extent of each debtor's unperformed share.

(3) If a solidary debtor who has performed more than that debtor's share is unable, despite all reasonable efforts, to recover contribution from another solidary debtor, the share of the others, including the one who has performed, is increased proportionally.

COMMENTS

A. General

This Article gives the solidary debtor who has paid or performed more than that debtor's share a right of recourse against the co-debtors to the extent that they, or any of them, have not paid or performed their shares. The Article does not give a right of recourse before performance. However, the co-debtors are bound by the general duty of good faith which may, in certain situations, oblige them to contribute to the settlement of the debt before it has been satisfied by the debtor who is pursued by the creditor.

This Article should be read along with the following three Articles.

B. Personal right of recourse

Paragraph (1) deals with the debtor's personal action, generally recognised by national laws on the basis of mandate, benevolent intervention in another's affairs (*negotiorum gestio*) or unjustified enrichment. The text makes it clear that costs reasonably incurred can be added to the principal claimed.

C. Subrogatory recourse

Paragraph (2) allows the solidary debtor to exercise, in the context of the right of recourse, the rights and actions of the creditor. The rule therefore recognises what is known in a number of national systems as subrogatory recourse, by virtue of which the debtor who has performed more than a proper share benefits from securities obtained by the creditor. The debtor can choose the most advantageous course of action. The Article makes it clear, however, that the exercise of this right of subrogatory recourse must not prejudice the creditor. Such prejudice might occur because of a potential competition between the creditor who has not yet been fully paid and the debtor subrogated to the

creditor's rights. The rule gives effect to the adage that subrogation should not operate against the subrogated person - "*nemo contra se subrogare censetur*".

Illustration 1

Bank A agrees to a loan of €200,000 to a customer, B. The loan is secured by a real security and by a solidary obligation undertaken by C. C pays €150,000 for which C is subrogated to A. B being insolvent, the building subject to the real security is sold for €100,000, to be shared between A and C. By virtue of the rule in paragraph (2), the exercise by C as paying solidary debtor of the rights and actions of the creditor cannot prejudice A, the creditor, who will take €50,000. Without this rule the price might have been shared proportionately between the two holders of the real security, ranking equally - that is, €25,000 for A and €75,000 for C. A would then have lost €25,000.

D. Effect of inability to recover

Paragraph (3) contains a rule based on equitable considerations and commonly recognised. The risk of non-payment by one of the solidary debtors should be shared proportionally among the solvent debtors. The burden of the risk should not depend on which debtor the creditor chooses to pursue.

Illustration 2

A, B and C are under a solidary obligation to repay a sum of €12,000, A being liable for €6000, and B and C for €3000 each. The creditor claims the full amount from A who pays the full €12,000. B is insolvent. The shares of the two solvent debtors, A and C, are then increased in proportion to their respective shares. The ratio of A's share to C's share is 2:1. So, of the €3000 due by B, €2000 is apportioned to A and €1000 to C, which increases A's share to €8000 and C's to €4000.

III.-4:108: Performance, set-off and merger in solidary obligations

(1) Performance or set-off by a solidary debtor or set-off by the creditor against one solidary debtor discharges the other debtors in relation to the creditor to the extent of the performance or set-off.

(2) Merger of debts between a solidary debtor and the creditor discharges the other debtors only for the share of the debtor concerned.

COMMENTS

A. Effect of performance or set-off

The rule in paragraph (1) is the consequence of the extinction of the obligation by performance or by some equivalent, such as set-off. This has a discharging effect in relation to the creditor to the extent of the performance made or amount set off, subject of

course to the right of recourse of the debtor who has performed. In the event of bankruptcy it will be necessary to take account in appropriate cases of any restrictive rules of the applicable bankruptcy law.

Illustration 1

A lends €2,500,000 to B, C and D who are associates in a financial group. B becomes a creditor of A for €500,000 and gives notice of set-off. The solidary debt will be reduced to €2,000,000. The set-off will benefit the other debtors.

B. Effect of merger

The rule in paragraph (2) will apply where, for example, one of the debtors inherits from the creditor or there is an amalgamation of debtor and creditor companies. Where merger of debts (*confusio*) operates between the creditor and one of the debtors, the whole of the debt borne by the other debtors is reduced by the amount affected. If one of those debtors is insolvent, that debtor's share must be borne by all the debtors including the one concerned by the *confusio*, in application of the principle of III.-4:107 (Recourse between solidary debtors) paragraph (3).

Illustration 2

A is creditor of a solidary debt of €12,000 owed by B, C and D in equal shares. Following on an amalgamation, B becomes entitled to A's right. The right acquired by B is extinguished in relation to B by the operation of merger of debts (*confusio*), but subsists in relation to C and D to the amount of €8000. If C is insolvent, B and D must bear C's share by virtue of III.-4:107 (Recourse between solidary debtors) paragraph (3). B will be able to claim €6000 from D (4000 plus 2000).

III.-4:109: Release or settlement in solidary obligations

(1) When the creditor releases, or reaches a settlement with, one solidary debtor, the other debtors are discharged of liability for the share of that debtor.

(2) As between solidary debtors, the debtor who is discharged from that debtor's share is discharged only to the extent of the share at the time of the discharge and not from any supplementary share for which that debtor may subsequently become liable under III.-4:107 (Recourse between solidary debtors) paragraph (3).

(3) When the debtors have solidary liability for the same damage the discharge under paragraph (1) extends only so far as is necessary to prevent the creditor from recovering more than full reparation and the other debtors retain their rights of recourse against the released or settling debtor to the extent of that debtor's unperformed share.

COMMENTS

A. Effect of release or settlement

Few systems deal in full with the effects of both release and settlement. The rule in paragraph (1) is the same as for merger of debts under III.–4:108 (Performance, set-off and merger in solidary obligations) paragraph (2). It is equally appropriate in the present context. There is nothing to prevent a release or settlement from discharging the other debtors completely but there is no need to provide specifically for that. It can be done under the normal rules on renunciations of rights by unilateral juridical acts or contracts for the benefit of third parties.

B. Effect on later liability for supplementary share

It is fair that the discharged debtor should nonetheless bear any appropriate supplementary burden (under III.–4:107 (Recourse between solidary debtors) paragraph (3)) due to the insolvency of one of the other debtors.

Illustration

A has agreed to a commercial lease in favour of a partnership, the partners B, C and D being, under the applicable law, solidarily liable for the partnership debts. Arrears of €60,000 mount up. A releases B. C and D remain bound but only for €40,000. If D turns out to be insolvent, B will be bound to pay €10,000 in spite of the release.

C. Special rule for liability for same damage

Paragraph (3) contains a special rule for the case where two or more debtors have solidary liability for the same damage. The normal solution under paragraph (1) could give rise to potential injustice in cases of liability for damage. Why should the fact that the victim has settled with one of the wrongdoers for 50% of that wrongdoer's proper share (something which may have been done for good reasons, such as the inadequacy of that wrongdoer's insurance cover) deprive the victim of the right to recover from the others the full balance of the reparation due?

III.–4:110: Effect of judgment in solidary obligations

A decision by a court as to the liability to the creditor of one solidary debtor does not affect:

- (a) the liability to the creditor of the other solidary debtors; or*
- (b) the rights of recourse between the solidary debtors under III.–4:107 (Recourse between solidary debtors).*

COMMENTS

A. Effect of court decision as to liability of one debtor on liability of others

Under these rules the reference to a court extends to arbitrators. See Annex 1. It is also appropriate to bear in mind the provisions on good faith and fair dealing given the risk of a fraudulent collusion between the creditor and one of the debtors to adversely affect the others.

National laws adopt different solutions to the problem of a court decision as to the liability of one debtor - no effects on the other debtors; full effects in favour of, but not against, the other debtors. These rules opt for the solution whereby the decision has no effects on the other debtors who were not parties to it. The idea of reciprocal representation is rejected. Each debtor should be free to make maximum use of that debtor's own defensive resources. There will be no *res judicata* effect except in relation to those who were parties to the litigation.

B. Effect of court decision as to liability of one debtor on rights of recourse

The rule in sub-paragraph (b) is intended primarily to clarify the effects of a court decision that one debtor is not liable in relation to the rights of recourse which the other debtors have. The rule on the absence of wider effects of the court decision applies here also. The other debtors retain their rights of recourse. Of course, a decision by a court that one debtor is liable does not prevent that debtor from exercising the right of recourse against the others: this situation too is covered by sub-paragraph (b).

III.-4:111: Prescription in solidary obligations

Prescription of the creditor's right to performance against one solidary debtor does not affect:

- (a) the liability to the creditor of the other solidary debtors; or*
- (b) the rights of recourse between the solidary debtors under III.-4:107 (Recourse between solidary debtors).*

COMMENTS

This Article deals with a matter which is treated differently in the various laws. Under sub-paragraph (a) the effect of prescription is personal to the debtor concerned and does not affect the liability of the other debtors to the creditor. There is no reason why the other debtors should benefit from the prescription of the claim against one debtor when the claims against them have not prescribed. This rule fits in well with the way prescription operates under these rules: it does not extinguish the claim automatically but merely gives the debtor a right to refuse performance.

Sub-paragraph (b) is justified primarily by the need to protect a debtor (not the one whose debt has prescribed) who has paid more than that debtor's share. Such a debtor should not be deprived, by the creditor's inaction, of the right of recourse against the debtor whose debt has prescribed. Sub-paragraph (b) also protects the debtor whose debt has prescribed but who nonetheless pays. As prescription under these rules does not extinguish the obligation it follows that such a debtor is fulfilling an existing obligation and is entitled to any available right of recourse against the co-debtors.

Illustration

A has lent €20,000 to B and C, who are solidary debtors. After 3 years the claim against B has prescribed but, because C has acknowledged the claim, the period of prescription against C has not yet expired. At this stage A cannot compel B to pay but can proceed against C for the whole amount. By virtue of the rule in paragraph (2), if C pays the whole amount C will be able to reclaim €10,000 from B.

III.-4:112: Opposability of other defences in solidary obligations

(1) A solidary debtor may invoke against the creditor any defence which another solidary debtor can invoke, other than a defence personal to that other debtor. Invoking the defence has no effect with regard to the other solidary debtors.

(2) A debtor from whom contribution is claimed may invoke against the claimant any personal defence that that debtor could have invoked against the creditor.

COMMENTS

Paragraph (1) recognises the traditional distinction between defences inherent in the debt itself and defences personal to each of the debtors. Only defences of the first type can be pleaded by all the debtors. Personal defences are exclusive to the debtors concerned.

Defences inherent in the debt are those, such as illegality or non-compliance with a formal requirement, which flow from the contract itself. Personal defences are those, such as lack of free consent or incapacity, which relate only to the personal position of one of the debtors. Indeed, the possibility of avoiding the contract for a defect in consent is necessarily personal to the person whose consent was affected.

Illustration 1

A, B and C borrow €50,000 from D at a rate of interest of 12%. The contract is in French. C, who does not speak French, is subject to an error producing a lack of true consent. B, if pursued by the creditor, cannot take advantage of this.

Paragraph (2) provides that personal defences can be pleaded against a debtor who claims a contribution from a co-debtor, whether the recourse is by personal action (III -4:107

(Recourse between solidary debtors) paragraph (1)) or based on subrogation (III.–4:107 (Recourse between solidary debtors) paragraph (2)).

Illustration 2

The facts are as in Illustration 1. B, having paid the whole amount to D, now seeks recourse against C. C can found on the lack of true consent to defeat B's claim.

Section 2: Plurality of creditors

III.–4:201: Scope of section

This Section applies where two or more creditors have a right to performance under one obligation.

COMMENTS

This Section is not intended to cover all cases where there is a plurality of creditors. It does not deal with an accumulation of rights arising out of multiple contracts concluded by several creditors with one person, such as customers who order merchandise from one dealer. The existence of such parallel contracts does not affect their legal nature.

Plurality of creditors is not a topic which is dealt with explicitly in the laws of all the Member States, but it is sufficiently important that it is useful to set out a clear system of rules.

III.–4:202: Solidary, divided and joint rights

(1) A right to performance is solidary when any of the creditors may require full performance from the debtor and the debtor may perform to any of the creditors.

(2) A right to performance is divided when each creditor may require performance only of that creditor's share and the debtor owes each creditor only that creditor's share.

(3) A right to performance is joint when any creditor may require performance only for the benefit of all the creditors and the debtor must perform to all the creditors.

COMMENTS

A. General

The typology of plural rights to performance follows that of plural obligations (III.–4:102 (Solidary, divided and joint obligations) . Solidary rights, divided rights and joint rights are thus, broadly speaking, the converse of solidary, divided and joint obligations. The

following Articles in this Chapter are not, however, a simple reflection of the Articles on a plurality of debtors.

B. Solidary rights

Solidarity of rights is comparatively rare. It is not the default rule under this Chapter. See the following Article. Because of the risks inherent in solidarity of rights (notably, that one creditor may claim and squander the whole funds) it would not be appropriate as the default rule. For the same reason, solidarity of rights is rarely stipulated for by the parties. It is, however, frequently encountered in relation to bank accounts, particularly joint accounts where the holders are solidary creditors of the bank.

The definition of solidary rights given here reflects their characteristic features. Each creditor can obtain from the debtor the totality of the debt without the debtor being able to plead that it should be divided. Reciprocally, the debtor can make payment of the whole debt to one of the creditors, at the debtor's choice, thereby being discharged in relation to all the creditors. The debtor retains this choice even when faced with demands from all or any of the creditors.

In the event of non-performance by the debtor in the face of a claim by one of the creditors, the creditor can put in operation the various remedies for non-performance provided by these rules, without any obligation to act in concert with the other creditors. So, the creditor can terminate for fundamental non-performance, if there is substantial non-performance by the debtor. Similarly, the creditor can withhold performance of reciprocal obligations until the debtor performs or tenders performance.

C. Divided rights

Divided rights are the most frequent in practice. It follows that the relative practical importance of the different categories of plurality is different in the case of rights and obligations.

D. Joint rights

Joint rights arise when the performance is indivisible and when it can be rendered only for the benefit of all the creditors. A common field of application for joint rights is that of joint and indivisible bank accounts. Another is contracts concluded by the title holders of property held jointly and indivisibly, as may happen, depending on the applicable law, under the law of trusts or succession.

It is of the essence of joint rights that their exercise is in the hands of all the creditors. It is conceivable, however, that one of the creditors may have received a mandate or authority from the others to receive the funds or performance due.

Illustration 1

A and B, members of a partnership or society which does not have legal personality, open a joint bank account as such members. They are joint creditors of the bank.

Illustration 2

A engages a married couple as caretakers and makes a caretakers' apartment available to them. Each is a joint creditor of the right to the tenancy.

Illustration 3

A group of friends hire a car with a driver for a joint excursion. The driver's performance can only be rendered for the benefit of the whole group, the members being accordingly creditors of a joint claim.

Where the debtor, in a case of joint rights, does not perform the obligation, the question arises whether the creditors must act in concert against the debtor or whether it is sufficient for one of them to act for the benefit of all. The Article, in providing that "any creditor can require performance only for the benefit of all", facilitates recovery and allows the creditors to avoid the paralysis which would otherwise result from the inaction of one of their number.

Illustration 4

A is the debtor in relation to a joint claim held by B and C. The debt is due but has not been paid. C can sue A for payment of the debt to both creditors.

Non-performance by the debtor in the case of joint rights necessarily affects the whole of the contract. The nature of the rights, and corresponding obligation, makes a termination or suspension by only one or some of the creditors inconceivable. All the creditors will have to act together to terminate for fundamental non-performance or to withhold performance of reciprocal obligations.

Illustration 5

The facts are as in Illustration 3. The driver does not turn up on the agreed date. The group of friends want to recover the money paid in advance. They will have to give notice of termination jointly to the debtor or authorise one of them to give notice on behalf of all.

III.-4:203: When different types of right arise

(1) Whether a right to performance is solidary, divided or communal depends on the terms regulating right.

(2) The default rule is that the right of co-creditors is divided.

COMMENTS

This Article sets out the default rule for plurality of creditors. As noted above the rule is different from that applying to a plurality of debtors. There solidarity is the default rule. However, that would be dangerous for creditors because any one of them could claim performance to the prejudice of the others. So the default rule for creditors is that their right is divided. This regime will apply unless the terms regulating the right (typically the terms of a contract) provide otherwise or the nature of the right itself indicates otherwise.

III.-4:204: Apportionment in cases of divided rights

Creditors whose rights are divided are entitled to equal shares.

COMMENTS

This provision is the counterpart of the rule applying in the case of a plurality of debtors. The general rule laid down in the Article may be displaced by contrary provision in the terms regulating the right.

Illustration

A and B lend €10,000 to C. In the absence of any special provision, C owes €5000 to each of the creditors. Conceivably, however, a term in the contract might provide for a different apportionment because, for example, of a debt owed by one of the creditors to the other.

III.-4:205: Difficulties of performing in cases of joint rights

If one of the creditors who have joint rights to performance refuses to accept, or is unable to receive, the performance, the debtor may obtain discharge from the obligation by depositing the property or money with a third party according to III.-2:111 (Property not accepted) or III.-2:112 (Money not accepted).

COMMENTS

This rule is intended to protect the debtor who, without it, could not obtain an effective discharge if one of the creditors refused, or was unable, to receive the performance. It will be remembered that the debtor must render the performance to the creditors together. Because of the rule in the present Article the debtor will, in case of difficulty caused by this requirement, be able to put into operation the measures provided for by III.-2:111 (Property not accepted) or III.-2:112 (Money not accepted).

Illustration

A and B buy a second hand car from C, the contract making it clear that they have a joint claim. B is hospitalised and, because of his condition, is not able to receive

the performance or give a mandate to A. C wants to deliver the car at the agreed time. C cannot deliver the car for the sole benefit of A, because A and B have a joint claim. C will be able to deposit the car with a third party for the benefit of A and B according to the rules laid down in III.–2:111 (Property not accepted).

III.–4:206: Apportionment in cases of solidary rights

(1) Solidary creditors are entitled to equal shares.

(2) A creditor who has received more than that creditor's share must transfer the excess to the other creditors to the extent of their respective shares.

COMMENTS

Paragraph (1) is the counterpart of the rule on apportionment between solidary debtors. Like that rule, it is only a default rule. The terms constituting the solidarity will generally specify the share due to each of the creditors. In the absence of such provision, sharing will be in equal parts.

Paragraph (2) lays down an understandable rule. A creditor who has received more than that creditor's share obviously cannot be allowed to keep the excess. It must be handed over to the other creditors.

Illustration

A and B are solidary creditors of C for an amount of €10,000. C pays €10,000 to B. A has a right of recourse against B for €5000.

III.–4:207: Regime of solidary rights

(1) A release granted to the debtor by one of the solidary creditors has no effect on the other solidary creditors.

(2) The rules of III.–4:108 (Performance, set-off and merger in solidary obligations), III.–4:110 (Effect of judgment in solidary obligations), III.–4:111 (Prescription in solidary obligations) and III.–4:112 (Opposability of other defences in solidary obligations) paragraph (1) apply, with appropriate adaptations, to solidary rights to performance.

COMMENTS

A. Release by one solidary creditor

Under paragraph (1) a release of the debt agreed to by one of the solidary creditors has no effect on the other creditors. This rule is different from the rule provided above for the

case of solidary obligations (III.–4:109 (Release or settlement in solidary obligations)). It means in effect that one creditor cannot dispose of the right to performance to the detriment of the other or others.

Illustration 1

A and B are solidary creditors of C for the amount of €10,000. A grants a total release to C, who is therefore discharged in relation to A. A will no longer therefore be able to sue for recovery of the money. B remains creditor of C for the whole amount of €10,000.

The rule envisages only the release of the debt, as opposed to a settlement. A settlement, in so far as it provides for partial payment, will come under the rules on payment (see paragraph (2) read with III.–4:108 (Performance, set-off and merger in solidary obligations) paragraph (1)) and, in so far as it involves a release, will come under the rule of the present paragraph.

Illustration 2

A and B are solidary creditors of C for an amount of €10,000. A sues C and, in the course of the proceedings, concludes a settlement providing for a release of half the debt on payment of the other half. In accordance with the settlement C pays €5000 to A. The settlement cannot be pleaded against B who has the right to sue C. However, because of the partial payment which has been made, B can claim only €5000 (III.–4:207 (Regime of solidary rights) paragraph (2) read with III – 4:108 (Performance, set-off and merger in solidary obligations) paragraph (1)).

B. Application of certain rules for solidary obligations

The form of paragraph (2) is explained by the parallelism between plurality of debtors and plurality of creditors. It avoids a repetition of the relevant rules provided for the case of a plurality of debtors. The following consequences ensue.

By virtue of the application of III – 4:108(Performance, set-off and merger in solidary obligations) paragraph (1) both the payment of the debt and the operation of set-off between the debt due by the debtor and one of the rights discharge the debtor in relation to the co-creditors. It is the same in the case of merger (*confusio*): the debt is extinguished, but the debtor who has thus become creditor is exposed to the right of recourse of the other creditors, as provided by III.–4:206 (Apportionment in case of solidary rights) paragraph (2).

Illustration 3

A and B are solidary creditors of C for an amount of €10,000. B dies and C, his sole heir, succeeds. A will be able to claim €5000 from C, the new co-creditor.

In the same way, by virtue of III.–4:110 (Effect of judgment in solidary obligations), a court decision has effect only between the parties to the litigation.

Under III.–4:111 (Prescription in solidary obligations) paragraph (1), as applied to solidary rights, when one of the rights has prescribed, the other creditors keep their rights. Under paragraph (2) of that Article the creditor whose right has prescribed can nonetheless exercise a right of recourse (under III.–4:206 (Apportionment in case of solidary rights) paragraph (2)) against a creditor who has received more than a due share of the right.

Illustration 4

A and B are solidary creditors of C for an amount of €10,000. B's claim has prescribed but A's has not. A can proceed against C and recover the whole of the sum. B can then exercise a right of recourse against A to the extent of €5000.

Finally, by virtue of III.–4:112 (Opposability of other defences in solidary obligations) paragraph (1) the debtor can plead against the creditor any defences, personal or inherent in the debt, apart from any defences personal to another of the solidary creditors.

Illustration 5

A and B are solidary creditors of C for €10,000. C can argue against A that the contract giving rise to the rights is ineffective by reason of its illegality, as it relates to a matter which cannot be the object of a lawful contract. This would be a defence inherent in the debt.

Illustration 6

A joint bank account is opened in the names of A and B. B is legally incapable of contracting by reason of mental incapacity. A wants to make a withdrawal. The Bank cannot plead the incapacity of B against A. This is a personal defence which can be invoked only in the Bank's relations with B.

Paragraph (2) of III.–4:112 (Opposability of other defences in solidary obligations) is not applied by analogy to solidary rights. The creditor who has received full payment, the debtor being thereby discharged, is exposed to the right of recourse of the co-creditors without being able to plead against them the defences which the debtor could have used against them. The sharing of the amount due under the obligation should be regulated exclusively by the terms regulating the right of the solidary creditors.

Illustration 7

A and B are solidary creditors of C for an amount of €10,000. A sues C who pays €10,000. C could have pleaded a vice of consent against B. A will have to pay over €5000 to B, without being able to invoke the vice of consent which C could have pled against B.

CHAPTER 5: TRANSFER OF RIGHTS AND OBLIGATIONS

Section 1: Assignment of rights

Sub-section 1: General

III.-5:101: Scope of Section

(1) This Section applies to the assignment, by a contract or other juridical act, of a right to performance of an obligation.

(2) It does not apply to the transfer of a financial instrument or investment security where such transfer must be by entry in a register maintained by or for the issuer or where there are other requirements for transfer or restrictions on transfer.

COMMENTS

A. The topics covered by the Chapter

The Chapter covers three topics – an assignment of the right to performance to a person who becomes the new creditor; a change of debtor by the substitution of a new debtor for the existing debtor; and the transfer to another person of the entire contractual position, rights and obligations, of one party to a contract. These topics are related to each other; they all involve a change in the parties to a legal relationship; but they are also different in important respects.

An assignment of a right to performance, often a right to the payment of money, does not involve any transfer of the assignor's obligations. The debtor's own rights continue to lie solely against the assignor. Since an assignment does not involve the release of either of the parties to a contract, it does not require the consent of the debtor unless the underlying contract so provides. Assignment is therefore to be distinguished from the situation where a third party is substituted for the debtor, who is released from liability, an arrangement requiring the assent of all three parties (see Article III - 5:201). It is also to be distinguished from the situation where a third party is substituted completely for one of the contracting parties, taking over both rights and obligations. This also requires the assent of all three parties (see Article III - 5:301).

B. The topics covered by Section 1

Section 1 applies only to assignments by a contract or other juridical act. It does not apply to transfers of rights by operation of law – for example, on death or bankruptcy. It is common to find statutory provisions to the effect that on the amalgamation or re-organisation of certain organisations or bodies, or on the transfer of businesses, rights and obligations are transferred by operation of law to the new entity. The Section does not apply to such cases. Nor does it apply to the transfer of rights by mere delivery of a document of title or other such document.

The Section applies only to assignments of rights to performance of an obligation. This covers contractual and non-contractual rights to performance, such as rights to payment under a unilateral undertaking, or rights to the payment of damages for non-performance of a contract, or rights under the law on unjustified enrichment to have an enrichment reversed by the payment of money or transfer of property. In practice, rights of various types are often intermingled and it would be inconvenient and unjustifiable to have one set of rules applying to the assignment of rights to performance of obligations under a contract and other rules applying to the assignment of other closely related rights to performance.

Rights to performance include rights to the payment of debts already payable or becoming payable in the future and rights to non-monetary performance such as the construction of buildings, the delivery of goods, and the provision of services. Rights to the performance of negative obligations, such as obligations not to compete within a certain area for a certain time, are also covered. However, the general limitations on the intended scope of these rules must be kept in mind. They are not intended to apply to public law rights and obligations. For example, the law conferring a right to certain social security payments may well provide that the right to the payments is not transferable. Nor is the Section intended to apply to family law rights and obligations

C. Financial instruments and investment securities

Although the holder of a bond or stock in the nature of a registered financial instrument or investment security will have a right to payment against the issuer, such instruments or securities differ in important respects from ordinary rights governed by the law of obligations. Their transfer will be governed by special rules, generally involving an entry in the issuer's register. They are therefore excluded from the scope of this Chapter.

D. Negotiable instruments

Under the general provisions on the scope of these rules (I.-1:101 (Intended field of application)) bills of exchange and other negotiable instruments are excluded. This is of particular relevance in the present context. Although a bill of exchange or other negotiable instrument may set up a series of contractual relationships, the transfer of rights under a negotiable instrument is usually effected by delivery, with any necessary endorsement, not by assignment. Since the obligation of the party or parties liable on the instrument is to pay the current holder, who may not be the original payee, there is no requirement of notice of the transfer as there would be for an assignment; and a debtor who pays an assignee who is not the holder of the instrument remains liable to the holder. Moreover, negotiable instruments are by their nature governed by distinct rules which in various respects differ sharply from those applicable to assignments. For example, a person taking a negotiable instrument for value and without notice of any defect in the transferor's title is not affected by such a defect or by defences that would have been available against the transferor, whereas an assignee takes subject to these matters.

While negotiable instruments as such are outside the scope of these rules, this does not necessarily preclude an assignment of the underlying right to payment. This is most likely

to occur in a global assignment of assets which does not involve the delivery of negotiable instruments. Where a right to payment embodied in a negotiable instrument is assigned, negotiable instruments law will usually give the holder of the instrument priority over the assignee. This also is a matter not covered by the present Chapter.

E. Importance of assignment

Rights to payment or other performance of obligations represent a major tradable asset. They can be sold outright, as in the typical factoring transaction, or assigned by way of security for a loan or other obligation. The purpose of Section 1 of this Chapter is to set out principles and rules which are designed to facilitate the assignment of rights, whether individually or in bulk, whilst at the same time ensuring that the debtor's rights are not prejudiced by the assignment.

III.-5:102: Definitions

(1) An “assignment” of a right is the transfer of the right from one person (the “assignor”) to another person (the “assignee”).

(2) An “act of assignment” is a contract or other juridical act which is intended to effect a transfer of the right.

(3) Where part of a right is assigned, any reference in this Section to a right includes a reference to the assigned part of the right.

COMMENTS

A. Definitions

This Article introduces the key terms of “assignment”, “act of assignment”, “assignor”, and “assignee”.

An “assignment” of a right is defined as a transfer of the right from one person to another person. The preceding Article has already made it clear, however, that the rules in this Section are limited to voluntary transfers – that is, transfers by a contract or other juridical act. They do not apply to the transfer of rights by operation of law (for example by way of legal subrogation). The purpose of the transfer does not matter. It may be to give effect to an agreement to sell. It may be to give effect to a legal obligation to assign arising from some other source, such as a statute. It may be gratuitous. It may be for purposes of security or a trust. However, in the last two cases there are special rules elsewhere in these rules which have priority. The present Section will apply only subsidiarily in so far as a matter is not regulated by those special rules. See the following Article.

The “assignor” is the creditor who transfers the right. The “assignee” is the person to whom it is transferred.

An “*act of assignment*” is defined as a contract or other juridical act which is intended to effect a transfer of the right. In many cases the contract or other juridical act will actually effect the transfer. But there can be situations where, for one reason or another, the contract or other juridical act fails to achieve its purpose. For example, the right may be non-assignable by law. Or the person purporting to assign the right may not be the creditor. This is why it is defined in terms of what is intended rather than in terms of what is achieved.

The “act of assignment” (i.e. the contract or other juridical act which is intended to effect the transfer and which may actually effect the transfer) must be distinguished from the assignment itself – the transfer of the right from the assignor to the assignee – the result of an effective act of assignment. The act of assignment must also be distinguished from the underlying obligation to assign, if there is one. An act of assignment will often derive from an agreement to assign. In some cases an agreement to assign is separate from and prior to the act of assignment and governs the wider business transaction or relationship of which the assignment will form part. In such cases the act of assignment may be a very simple unilateral act which contains no express undertakings or supplementary provisions at all. In other cases the agreement and the act of assignment may be embodied in a single contract document. The formation and validity of acts of assignment are governed by the general provisions on contracts and other juridical acts and not by this Chapter.

In these rules a valid agreement for an immediate assignment (or equivalent juridical act) suffices to effect the assignment if the other requirements of III.–5:104 (Basic requirements) are met, and (unlike in some of the Member States’ laws) there is no principle of abstraction. Thus if the agreement to assign (or juridical act) is invalid, there will not be an effective assignment.

“*Right*” includes *part of right*. In some cases, but not in all, a right can be assigned in part. (See III.–5:107 (Assignability in part) .) Paragraph (3) is inserted purely for drafting purposes – to avoid the need for constant repetition of “right or part of the right”.

III.–5:103: Priority of provisions on proprietary securities and trusts

(1) In relation to assignments for purposes of security, the provisions of Book IX apply and have priority over the provisions in this Chapter.

(2) In relation to assignments for purposes of a trust, or to or from a trust, the provisions of Book X apply and have priority over the provisions in this Chapter.

COMMENTS

This Article serves as a reminder that there are special rules in other Books on proprietary securities and on trusts and that, in so far as there is any conflict, those rules will take

priority over the rules of the present Chapter. Subject to that priority the rules of the present Chapter apply to assignments for any purpose.

Sub-section 2: Requirements for assignment

III.–5:104: Basic requirements

- (1) The requirements for an assignment of a right to performance are that:*
- (a) the right exists;*
 - (b) the right is assignable;*
 - (c) there is a valid act of assignment of the right; and*
 - (d) the person purporting to assign the right is entitled to transfer it.*
- (2) Neither notice to the debtor nor the consent of the debtor to the assignment is required.*

COMMENTS

A. The four essential requirements

Paragraph (1) sets out the four essential requirements for an assignment of a right – that is to say, for an actual transfer. An act of assignment may be wider in scope. It may relate to rights which do not yet exist, or which are not yet assignable (e.g. because the debtor has not yet consented in a case where such consent is required) or which have not yet been acquired by the granter. This Article is not concerned with what an act of assignment may cover but with the requirements for an actual assignment. The several ingredients are elaborated in subsequent Articles. The time when an assignment takes place is covered in III.–5:114 (When assignment takes place).

B. Notice to debtor not a constitutive requirement

Paragraph (2) makes it clear that notice to the debtor is not required to effect the transfer of the right from the assignor to the assignee. However, as will be seen later, notice to the debtor plays a significant role in identifying a point in time after which the debtor is not discharged by paying to the assignor.

In some legal systems an assignment of a right is not validly constituted unless and until notice of the assignment has been given to the debtor or some other overt act performed, such as entry of the assignment in the assignor's accounting records. Failing such notice or equivalent act the assignment (i.e. the transfer of the right) is of no effect. The person attempting to assign the right remains the creditor.

There are two reasons for the approach adopted in the Article. The first relates to the question whether the notice requirement serves any useful purpose. Notice to the debtor is not equivalent to public notice (for example, by registration), since it is visible only to

the debtor. While a requirement of notice may help to prevent a collusive ante-dating of an assignment made, for example, to overcome insolvency rules governing unfair preference, the date of an assignment is rarely in question and can usually be established by other means. The second, and more important, reason for omitting notice as a constitutive requirement is that it is inimical to modern receivables financing, which involves acts of assignment relating to a continuous stream of receivables arising from both present and future contracts. In the nature of things, future debtors cannot normally be identified at the time of the act of assignment. Moreover, in recent years there has been a sharp movement, particularly in factoring operations, from notification to non-notification financing, also known as invoice discounting, in order to avoid disturbing relations between the assignor-supplier and its customer, the debtor, and to allow the assignor to collect in the debts on behalf of the assignee. The use of non-notification financing depends heavily on the validity of the transfer of the debts from assignor to assignee. Accordingly any requirement of notice to the debtor as a constitutive element of the assignment could seriously undermine receivables financing generally and non-notification financing in particular.

C. Consent of debtor not normally required

Paragraph (2) also makes it clear that the consent of the debtor is not normally required for an assignment. There are, however, some cases where by law an assignment requires the consent of the debtor. One example is where there is an effective contractual prohibition of assignment. (See III.-5:108 (Assignability: effect of contractual prohibition)).

D. No requirement of underlying obligation

In most cases an assignment will be made because of an underlying obligation to make it. However, this is not an essential requirement under the present Article. A person can transfer a right to another even if not obliged to do so, and it does not matter whether there never has been an obligation or whether there has been an obligation which has come to an end before the assignment.

Illustration 1

X concludes a contract with Y whereby X will assign a right to Y in a year's time. The contract is void because X is under the age of legal capacity for juridical acts. A year later X is no longer under the age of legal capacity. X knows the contract is void and that he is under no obligation to assign the right but decides to assign it anyway. The assignment is not invalid merely because the underlying contract giving rise to the obligation to assign was invalid.

Illustration 2

X is under an obligation to assign a right to Y. The obligation is time-limited and comes to an end in July. In August X, knowing that the obligation has come to an end, decides that it would be more honourable in the circumstances to assign the right anyway and does so. The assignment is not invalid merely because the underlying obligation has expired.

In the above cases the act of assignment will in effect be a gratuitous act and will have to comply with the requirements for such an act.

In many cases the underlying contract creating an obligation to assign and the act of assignment itself will be rolled up into one document or transaction and will both be affected by any relevant ground of invalidity such as mistake or coercion. Even where they are separate they may both be affected by the ground of invalidity.

The question whether a right which has been assigned has to be re-assigned when the underlying obligation is later terminated or extinguished is governed by the rules in Chapter 8 on the effects of the extinction of obligations.

III.–5:105: Assignability: general rule

(1) All rights to performance are assignable except where otherwise provided by law.

(2) A right to performance which is by law accessory to another right is not assignable separately from that right.

COMMENTS

A. The general rule of assignability

The general rule is that all rights to performance of an obligation are assignable. This is, however, subject to any rules of law which limit or prohibit assignment. For example, III.–5:109 (Assignability: rights personal to the creditor) provides that certain rights of a personal nature are not assignable. There may also be restrictions in national laws.

Illustration 1

H, a private individual, purports to assign all his future income and assets to A as security for a loan. Proceedings are brought in England to enforce payment. Under English law the assignment is void as contrary to public policy in that its effect is to deprive the assignor of all means of livelihood. This overriding rule of English law will displace the general rule of assignability.

There will often be mandatory rules to the effect that certain types of accessory rights cannot be transferred separately but only along with the main right.

B. Effect of contractual prohibition of assignment

The effect of a contractual prohibition of assignment is dealt with in III.–5:108 (Assignability: effect of contractual prohibition).

C. Existing rights to future performance

The rights which can be assigned need not be immediately exigible. A right to a payment at some time in the future can be assigned and this applies even if the payment still has to be earned.

Illustration 2

A company, C, has entered into a contract with E to construct a factory, payment to be made in stages against architects' certificates. C may validly assign its rights to future payment although these are dependent on its execution of the contract works.

D. Conditional rights

A conditional right can be assigned. The assignee will take it subject to the condition.

E. Accessory rights

An accessory right is not assignable separately from the right to which it is accessory. The typical example of an accessory right is a security right of a type which is dependent on the primary right. It is for other branches of the law to decide which rights are accessory and which are not.

III.-5:106: Future and unspecified rights

(1) A future right to performance may be the subject of an act of assignment but the transfer of the right depends on its coming into existence and being identifiable as the right to which the act of assignment relates.

(2) A number of rights to performance may be assigned without individual specification if, at the time when the assignment is to take place in relation to them, they are identifiable as rights to which the act of assignment relates.

COMMENTS

A. Future rights

Difficulty has been experienced with the assignment of future rights – that is, rights which do not yet exist as opposed to rights which exist but which are subject to a time restriction or a condition. Future rights might, for example, be rights under contracts which have not yet been concluded. There is a concern about the economic effects on the assignor of parting with future assets and possible means of subsistence and a perception that an act of assignment requires specificity of subject-matter at the time of its making, coupled with notification to, or acceptance by, the debtor which is often impossible in the case of future rights. But the commercial importance of receivables financing (i.e. the provision of finance through the purchase of, or loans on the security of, rights to payment and other rights to performance) and the impracticability of requiring rights to be individually specified or determinable at the time of the act of assignment have led to

an increasingly general acceptance that an act of assignment can cover future rights and that the rights will then be transferred without the need for any new act of transfer once they come into existence. At the international level this is manifested by the 1988 UNIDROIT Convention on International Factoring and the UN Convention on Assignment of Receivables in International Trade. Under Article 5 of the former it suffices that the rights are identifiable to the assignment at the time they come into existence.

The present Article makes it clear that an act of assignment may relate to future rights. However, the actual transfer depends on the right coming into existence and being identifiable as the right covered by the act of assignment. No further act of assignment is required. The identifiability criterion need not be satisfied when the right comes into existence but must be satisfied before the right will be transferred.

Illustration 1

C, a credit card issuer, obtains a large loan from its bank, B, and agrees to assign to B its future rights against cardholders to a value not exceeding the amount of the loan. While this agreement is perfectly valid as a contract, it cannot effect a transfer, since it does not provide the means by which the assigned rights can be identified.

B. Rights not individually specified

Paragraph (2) makes it clear that there can be an assignment of a bundle of rights, the individual rights not being separately identified. This facility is important in practice. However, the rights must be capable of identification as covered by the act of assignment at the time when the assignment is to take place in relation to them.

Illustration 2

S, a company supplying timber to timber merchants, enters into a factoring agreement with F, a factoring company, by which S assigns to F by way of sale all its existing and future rights to payment arising under sale contracts made or to be made with S's customers carrying on business in the United Kingdom. This can validly effect assignments, since in relation to any future right it can be ascertained at the time it comes into existence whether it falls within the factoring agreement as a receivable due from a United Kingdom customer of S.

Illustration 3

S, a furniture manufacturer, supplies furniture to retail shops and department stores. S agrees to sell to F, a factoring company, such of its existing and future rights to payment as are listed in schedules from time to time sent by S to F. There can be effective assignments as to all rights so listed.

III.-5:107: Assignability in part

- (1) *A right to performance of a monetary obligation may be assigned in part.*
- (2) *A right to performance of a non-monetary obligation may be assigned in part only if:*
 - (a) *the debtor consents to the assignment; or*
 - (b) *the right is divisible and the assignment does not render the obligation significantly more burdensome.*
- (3) *Where a right is assigned in part the assignor is liable to the debtor for any increased costs which the debtor thereby incurs.*

COMMENTS

A. General

The creditor may not wish to assign the whole right but only such part as is necessary to achieve the commercial purpose of the assignment. For example, a company wishing to borrow €30 million from its bank on the security of a debt of €200 million owed to it by a third party may want to assign to the bank only such part of the debt as will provide the bank with adequate security for the loan. Similarly, a wholesaler who has contracted to buy a quantity of fungible goods to be delivered in two separate consignments to be separately paid for and who has orders from two sub-buyers, each for half the total quantity, may wish to assign the right to the first consignment to one sub-buyer and the right to the second to the other.

Whether a right may be assigned in part depends partly on whether it is a right to performance of a monetary obligation or a non-monetary obligation.

(i) *Rights to money*

Paragraph (1) provides that a right to performance of a monetary obligation may be assigned in part. Partial assignment of a right to the payment of money does not usually lead to any practical difficulties, though it may expose the debtor to increased costs, which under paragraph (3) the debtor would be entitled to recover (see Comment B).

Illustration 1

L lends B €10,000. L can assign to A the right to €4,000 forming part of the €10,000. If B incurs additional bank charges as the result of having to make two separate payments B is entitled to recover these from L or set them off against the liability to L.

(ii) *Rights other than to money*

Where the right is to performance of a non-monetary obligation the considerations are rather different. In the case of a non-monetary right it would often be unfair to the debtor to require a division of the performance, for this would change the relationship between performance and counter-performance in a manner which could prove detrimental to the

debtor and could lead to problems if the assignee wished to terminate for fundamental non-performance. Accordingly, paragraph (2) of the Article provides that a right to performance of a non-monetary obligation may, unless the debtor consents to the assignment, be assigned in part only if the right is divisible and the assignment does not render the obligation significantly more burdensome.

Illustration 2

S contracts to sell 100 computers to B, delivery to be made to B in Hamburg in four instalments of 25 computers each. B can assign to A the right to delivery in Hamburg of one, two or three instalments, but cannot assign the right to delivery of part of an instalment, for this would require S to divide the performance of a obligation which by its terms is indivisible as to each instalment. It might also, depending on the facts, render the obligation significantly more burdensome to S.

Illustration 3

F engages C to build a factory, including a tool shed, for €20 million, payable in stage payments against architects' certificates. If F sells the tool shed to A for €50,000 while retaining the rest of the factory, F cannot assign to A its rights under the contract as regards the tool shed, because the contract is an entire contract under which C's performance is indivisible.

Illustration 4

The facts are as in Illustration 3 except that the contract allocates a separate price to the tool shed and stipulates that this is to become payable on completion of its construction. On selling the tool shed F can assign its rights relating to the construction of the tool shed.

B. Security or other accessory rights

Assignment of part of a right in conformity with this Article carries with it a transfer of a *pro rata* share of any security rights or other accessory rights securing performance of the debtor's obligations (III.–5:115 (Rights transferred to assignee) and obliges the assignor to transfer to the assignee a *pro rata* share of all transferable independent rights (III.–5:112 (Undertakings by assignor) paragraph (6)).

C. Protection of the debtor

From the debtor's perspective partial assignments have the disadvantage of bringing exposure to the expense and inconvenience of multiple rights. The debtor is already protected to some extent by the provision in paragraph (2) to the effect that a non-monetary right, even if of a divisible nature, cannot be assigned without the debtor's consent if that would render the obligation significantly more burdensome to the debtor. Paragraph (3) of the Article gives further protection by providing that where a right is assigned in part the assignor is liable to the debtor for any increased costs which the debtor thereby incurs.

A risk arises where the right as a whole is disputed, in which event the debtor, having pleaded and called evidence in one case, would face the burden of doing so all over again in subsequent proceedings, with the danger of conflicting decisions, the debtor's defence being upheld in one case and rejected in another. For these types of case the debtor's protection must be found in the applicable procedural law.

III.-5:108: Assignability: effect of contractual prohibition

(1) A contractual prohibition of, or restriction on, the assignment of a right does not affect the assignability of the right.

(2) However, where a right is assigned in breach of such a prohibition or restriction:

(a) the debtor may perform in favour of the assignor and is discharged by so doing; and

(b) the debtor retains all rights of set-off against the assignor as if the right had not been assigned.

(3) Where the debtor is discharged under paragraph (2) by performing in favour of the assignor, the assignee's claim against the assignor for the proceeds has priority over the right of a competing claimant so long as the proceeds are held by the assignor and are reasonably identifiable from the other assets of the assignor.

(4) Paragraph (2) does not apply if:

(a) the debtor has consented to the assignment; or

(b) the debtor has caused the assignee to believe on reasonable grounds that there was no such prohibition or restriction.

[(5) If the assigned right is a right to payment for the provision of goods or services paragraph (2)(a) does not apply but, without prejudice to III.-5:116 (Effect on defences and rights of set-off), the debtor can invoke against the assignee all rights of set-off retained against the assignor by virtue of paragraph (2)(b).]

(6) The fact that a right is assignable notwithstanding a contractual prohibition or restriction does not affect the assignor's liability to the debtor for any breach of the prohibition or restriction.

COMMENTS

A. Conflicting interests

Where a contract contains a clause prohibiting the creditor from assigning rights under it two conflicting interests immediately come into play.

One interest is respect for freedom of contract and party autonomy. A contractual prohibition should in principle be respected. The debtor may have good commercial reasons for inserting a no-assignment clause. In the first place, the debtor may not want to have to deal with an unknown creditor who may be more severe than the assignor. Secondly, the debtor may wish to avoid the risk of overlooking the notice of assignment

and paying the assignor, in which event there would be a risk of having to make a payment or give other performance a second time, to the assignee. Thirdly, a debtor who expects to have continued mutual dealings with the creditor will wish to preserve the right of set-off, a right which would be cut off as regards cross-rights arising after receipt of notice of assignment. Fourthly, the assignee may be incorporated or have its principal place of business in a jurisdiction whose legal or tax regime is unfavourable to the transaction. There is, therefore, an argument for saying that an assignment in breach of a no-assignment clause should be ineffective, whether the contract contains an outright prohibition or restricts the creditor's right to assign, e.g. by requiring the debtor's consent.

The other relevant interest is in the free alienability of assets. Rights to performance of obligations, particularly monetary obligations, are important assets. The marketability of monetary rights is of enormous practical and economic importance. In relation to the transfer of movables it is a widely accepted principle, adopted also in these rules, that contractual prohibitions or restrictions do not affect transferability. The market in monetary rights is no less important today than the market in movables.

The laws of the Member States differ in the effect they give to anti-assignment clauses.

B. Balancing the interests

There are various ways in which the interests in freedom of contract and the interest in the alienability of assets can be balanced. One way, adopted in the UNIDROIT Principles (art. 9.1.9) and to a more limited extent in the Principles of European Contract Law (art. 11:301) is to distinguish between monetary rights, or some monetary rights, and other rights and to allow the first to be more freely assignable than the second, in spite of a contractual prohibition. However, such a distinction, especially if limited to certain types of monetary rights (such as in PECL "future rights to the payment of money") risks giving inadequate weight to the interest in alienability, which is not confined to certain categories of monetary rights or even exclusively to monetary rights.

The present Article adopts two techniques to balance the interests, one applying to assignments in general and the other only to assignments of trade receivables (see para (5) and Comment C below). The general technique is to allow the right to be transferable (thus recognising fully the interest in alienability) while providing that the debtor can obtain a good discharge by performing to the assignor (even although the assignor is no longer the creditor). The debtor also preserves full rights of set-off against the assignor as if the right had not been assigned. This does not affect the debtor's right under III.-5:116 (Effect on defences and rights of set-off) to invoke certain defences and rights of set-off against *the assignee* if the debtor chooses to pay the assignee and not the assignor. The debtor can also recover damages from the assignor for any loss caused by breach of the restriction or prohibition, although in practice such loss is likely to be minimal if the debtor is allowed to continue to perform in favour of the assignor. The debtor's interests are therefore protected and the principle of freedom of contract is respected so far as is

possible consistent with not restricting alienability. The rules for the protection of the debtor do not prevent the debtor from consenting to, or acquiescing in, the assignment and paying the assignee, should the debtor wish to do so. The debtor is permitted, but not obliged, to pay the assignor. The notion that the debtor can obtain a good discharge by paying someone who is not the creditor is perhaps strange at first sight but it is not unfamiliar in this context. It is widely recognised, for example, that a debtor who has not been notified of an assignment and does not know of it can obtain a good discharge by paying the assignor. This is the position under these rules also (see III.-5:118 (Performance to person who is not the creditor)).

A practical advantage of the solution adopted here is that the assignee becomes the holder of the right as soon as the assignment takes effect and, as a result, is protected from the assignor's creditors so long as the right continues to exist. Once the debtor pays the assignor and is discharged the assignee can recover the proceeds from the assignor on the basis of unjustified enrichment. The assignor has been enriched by receiving a payment which discharges the debtor and therefore causes the assignee to suffer a corresponding disadvantage. The question of priority in the proceeds after the right is extinguished by performance is dealt with in paragraph (3) in a way similar to that employed in article 24 of the United Nations Convention on the Assignment of Receivables in International Trade. The assignee's claim to the proceeds has priority over competing claims, such as the claims of the assignor's creditors, so long as the proceeds are separately identifiable in the assignee's funds. There is a particular need to protect the assignee in this situation because the assignee cannot obtain protection in the normal way by notifying the debtor. The assignee is helpless to prevent the debtor from paying the assignor. The fact that the debtor is allowed to pay the assignor and thus obtain some benefit from the contractual prohibition should not prejudice any more than is necessary the position of the assignee in relation to the assignor and the assignor's creditors.

C. Exceptions to rule that debtor can perform to assignor

The general rule stated in paragraph (2) is for the protection of the debtor. There is therefore no need for it if the debtor has consented to the assignment and no justification for it if the debtor has misled the assignee into believing that there is no prohibition or restriction. Exceptions for these situations are provided in paragraph (4).

A further, but more limited, exception is provided in paragraph (5). This applies a special rule for "trade receivables", a rule which is not found in the laws of the Member States but which has been adopted in a number of international conventions and also throughout much of North America. It is justified by a different consideration – the interest in enabling "trade receivables" to be used a source of finance. In this case too the assignment is completely effective and the debtor who has been notified of the assignment must pay the assignee. This exception is particularly necessary where the assignment relates to a continuing stream of future debts, for example, by a supplier to a factor under a factoring agreement. In this type of arrangement it is manifestly impossible to expect the factor to scrutinise the individual contracts, which may run into hundreds, in order to see whether these contain a provision against assignment. Even where, as will

usually be the case, the contract is a standard-term contract which does not embody such a provision, the assignee who examines one such contract cannot be sure that the assignor will not at some stage change the terms without notification. So paragraph (5) allows the assignment to take effect where it is an assignment of a right to payment for the provision of goods or services. However, the debtor can invoke against the assignee not only the normal defences and rights of set-off allowed by III.-5:116 (Effect on defences and rights of set-off) in the case of any assignment but also any right of set-off against the assignor even in relation to debts arising after the date of notification of the assignment. The practical effect of this is that, contrary to the normal rule applying in the absence of a contractual prohibition, the debtor can invoke against the assignee rights of set-off arising against the assignor in the period after the assignment has been notified to the debtor but before payment to the assignee. This exception is confined to the assignment of rights to the payment of money for the provision of goods or services; for it is in the field of receivables financing that the no-assignment clause typically creates problems. The exception in paragraph (5) represents a response to commercial needs which is steadily gaining acceptance. See, for example, the American Uniform Commercial Code, Revised Article 9, section 9-406(d); the 1988 UNIDROIT Convention on International Factoring, Article 6(1); and the UN Convention on the Assignment of Receivables in International Trade (2001), Article 9. As is indicated by the square brackets, the precise scope of this exception is still under consideration.

D. Right may be non-assignable for another reason

The Article deals only with the effect of a contractual prohibition or restriction on assignment. It is only such a prohibition or restriction which is denied effect by paragraph (1). If the right is non-assignable by law for another reason it will remain non-assignable. For example, a right may be non-assignable by virtue of the following Article on the ground that performance would be so personal to the creditor that the debtor could not reasonably be expected to render performance to anyone else. The rule in paragraph (1) would not render such a non-assignable right assignable merely because it had been reinforced by a contractual prohibition.

E. Assignor remains liable to debtor for non-performance of obligation

The overriding of contractual prohibitions or restrictions do not affect the assignor's liability to the debtor for non-performance of the obligation not to assign, a point made clear by paragraph (6).

III.-5:109: Assignability: rights personal to the creditor

(1) A right is not assignable if it is a right to a performance which the debtor, by reason of the nature of the performance or the relationship between the debtor and the creditor, could not reasonably be required to render to anyone except that creditor.

(2) Paragraph (1) does not apply if the debtor has consented to the assignment.

COMMENTS

A. Rights personal to the creditor

In a sense, every assignment of a right changes the debtor's position in some degree. The debtor has to perform in favour of a different person, and that person may have a more stringent attitude towards enforcement of rights than the original creditor. That by itself is not a sufficient consideration to prevent the assignment.

There are, however, rights which by the nature of the subject-matter or the relationship between the parties are personal to the creditor, so that it would be unfair to expose the debtor to an obligation to perform to an assignee. Different legal systems have different formulations of the principle underlying this conception. Under some the rule is stated as being that rights to performance under personal contracts, or contracts for personal services, are not assignable; in others that a right cannot be assigned if this would significantly alter the nature or content of the performance or render counter-performance less likely. All these formulations would appear to be encompassed by the rule embodied in this Article, since they all presuppose that the identity of the original creditor is important to the debtor. The typical example given of an assignment that would materially increase the burden or risk on the debtor is one which relates to the assignment of rights under an insurance policy covering goods which the assignor is selling to the assignee. Since the personal character of the insured is material to the insurer's risk, to allow an assignment would be to expose the insurer to a risk of a kind different from that which it had agreed to accept. This is a factor indicating that the benefits of the insurance policy are intended to be personal to the insured.

Illustration

P agrees to publish a book W is writing. An act of assignment by P to A of P's right to call for the book from W is not effective to assign the right, since the character and reputation of the publishing house are matters of importance to an author and the publisher cannot be changed without the author's consent.

An employer's right to performance under a contract of employment also falls into the category of non-assignable rights, since for both parties the relationship is a personal one which does not in principle permit substitution of a new party as creditor without the consent of the other party to the contract.

Where an act of assignment is ineffective to transfer the right because of the present Article the intended assignee will normally have the right to recover damages from the intending assignor for non-performance of the obligation to assign.

B. Mandatory rules

Independently of this and the preceding Article, overriding mandatory rules may render a purported assignment ineffective.

III.–5:110: Act of assignment: formation and validity

(1) Subject to paragraphs (2) and (3), the rules of Book II on the formation and validity of contracts and other juridical acts apply to acts of assignment.

(2) The rules of Book IV.I on the formation and validity of contracts of donation apply to gratuitous acts of assignment.

(3) The rules of Book IX on the formation and validity of security agreements apply to acts of assignment for purposes of security.

COMMENTS

A. Application of general rules

An act of assignment will be a contract or other juridical act. The general rules on contracts and other juridical acts apply to it, unless it is of a type to which some special rule applies. It follows from these general rules that an act of assignment need not normally be in writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses. In practice, contracts or other juridical acts by which rights are assigned are almost invariably in writing but there is no need to embody this as a general legal requirement. Later Articles give adequate protection to the debtor.

B. Gratuitous assignments

The policy considerations which justify special rules for the formation and validity of contracts of donation (to be dealt with in the later Part IV.I on Gratuitous Contracts) also justify such a requirement for gratuitous assignments. Paragraph (2) therefore applies the donation rules by reference.

C. Assignments for purposes of security

The same applies to assignments for purposes of security. The special rules for security agreements (to be dealt with in the later Book on Proprietary Securities) are therefore applied.

III.–5:111: Entitlement to assign

(1) Only the creditor (whether acting directly or through a representative) or a person authorised by law to transfer the right is entitled to assign a right.

(2) The requirement of entitlement in III.–5:104 (Basic requirements) paragraph (1)(d) need not be satisfied at the time of the act of assignment but must be satisfied at the time the assignment is to take place.

COMMENTS

Even if there is an existing, assignable right and a valid act of assignment there will be no transfer of the right if the person purporting to assign it by the act of assignment is not entitled to do so.

Paragraph (1) provides that only the creditor is entitled to assign the right. The creditor may, in accordance with the rules on representation, authorise a representative to conclude the act of assignment on the creditor's behalf. The effects of representation, including the effect of ratification, are governed by the Chapter on that topic.

Paragraph (2) makes it clear that the requirement of entitlement to assign need not be satisfied when at the time of the act of assignment but must be satisfied at the time the assignment is to take place. A person can grant an act of assignment of a right yet to be acquired but the actual transfer of the right will not take place until it is acquired.

III.-5:112: Undertakings by assignor

(1) The undertakings in paragraphs (2) to (6) are included in the act of assignment unless the act of assignment or the circumstances indicate otherwise.

(2) The assignor undertakes that:

(a) the assigned right exists or will exist at the time when the assignment is to take effect;

(b) the assignor is entitled to assign the right or will be so entitled at the time when the assignment is to take effect.

(c) the debtor has no defences against an assertion of the right;

(d) the right will not be affected by any right of set-off available as between the assignor and the debtor; and

(e) the right has not been the subject of a prior assignment to another assignee and is not subject to any right in security in favour of any other person or to any other incumbrance.

(3) The assignor undertakes that any terms of a contract or other juridical act which have been disclosed to the assignee as terms regulating the right have not been modified and are not affected by any undisclosed agreement as to their meaning or effect which would be prejudicial to the assignee.

(4) The assignor undertakes that the terms of any contract or other juridical act from which the right arises will not be modified without the consent of the assignee unless the modification is provided for in the act of assignment or is one which is made in good faith and is of a nature to which the assignee could not reasonably object.

(5) The assignor undertakes not to conclude or grant any subsequent act of assignment of the same right which could lead to another person obtaining priority over the assignee.

(6) The assignor undertakes to transfer to the assignee, or to take such steps as are necessary to complete the transfer of, all transferable rights intended to secure the performance which are not already transferred by the assignment, and to transfer the proceeds of any non-transferable rights intended to secure the performance.

(7) The assignor does not represent that the debtor has, or will have, the ability to pay.

COMMENTS

A. General

A contract or other juridical act by which a right is assigned will normally impose obligations on the person assigning the right. The most basic obligation will be to assign the right in accordance with the contract or other juridical act.

Contracts or other juridical acts assigning rights frequently contain undertakings (warranties) by the assignor designed to ensure that the assignee acquires the benefit of the bargain. Often these are restricted to warranties as to the assignor's legal rights against the debtor and undertakings to perform any further acts necessary to perfect the assignee's title. Sometimes such undertakings go further and provide that if the debtor defaults the assignor will be liable for performance or will repurchase the assigned rights. In the absence of such a provision the normal rule is that the assignor incurs no liability for the debtor's non-performance. See paragraph (7).

In the absence of express provision in the contract or other juridical act of assignment the default rules relevant to the particular type of transaction may come into play. For example, if the right has been sold the default rules on the obligations of the seller and buyer will come into play. If the right has been donated the default rules applying to contracts of donation will come into play, and similarly if the right has been assigned in security. However, these background default rules may not cover every situation and it can be difficult to apply rules drafted primarily for corporeal movables to assignments of rights to performance. So, to fill any gaps and for the convenience of the user the present Article contains a set of implied undertakings which apply to any assignment unless otherwise provided. Such undertakings are found in many laws; in others they are often the subject of express provisions in the contract to assign. The undertakings by the assignor set out in the Article are designed to protect the assignee in the event that the assigned rights prove legally worthless or are subordinate to the interests of a prior party or are reduced in value by a modification of the contract under which they arise.

B. Existence and enforceability of right and entitlement to assign

Paragraph (2) of the Article imports undertakings that the right exists or will exist at the time when the assignment is to take effect, that the assignor is entitled to assign the right or will be so entitled at the time when the assignment is to take effect and that the right will not be subject to defences or rights of set-off against the assignor.

Illustration 1

C assigns to X by way of sale a batch of debts due from D. Subsequently C purports to assign the same debts to A by way of security for a loan. C thereby commits a breach of the undertaking to A that C is entitled to assign the right.

Illustration 2

C assigns to A a purported claim against D for the price of goods said to have been sold and delivered under a contract of sale. No such contract was ever made. C is liable to A for breach of the undertaking as to the existence of the claim.

Illustration 3

C assigns to A a purported claim against D for the price of goods sold and delivered under a contract of sale. When A sues D for non-payment of the price D successfully defends the claim on the ground that the goods were never delivered. C is liable to A for breach of the undertaking that D has no defence to the claim.

Illustration 4

C assigns to A all C's rights under a consumer credit agreement entered into by C as creditor with the debtor, D. C failed to comply with a statutory requirement that the agreement should state the annual percentage rate of charge for the credit. The statute provides that in such a case the agreement is unenforceable by C, though not by D. A can sue C for breach of the implied undertaking that D has no defences against an assertion of the right.

Illustration 5

C assigns to A a claim against D for repayment of a loan of €10,000. D does not dispute that the loan has become repayable but asserts a right to set off against it a cross-claim for €20,000 which is held to the credit of a separate account D holds with C. The existence of the right of set-off constitutes a breach of C's implied undertaking to A.

However, the undertaking is not broken by the existence of rights of set-off that do not affect the assignee, for example, set-off in respect of cross-claims by the debtor against the assignor arising from dealings between them after the debtor's receipt of notice of assignment (see III.-5:116 (Effect on defences and rights of set-off)). Moreover, the undertaking does not cover the assignee's inability to obtain performance because the debtor absconds or becomes bankrupt.

C. Freedom from prior rights

Paragraph (2)(e) imports an undertaking that the claim has not previously been assigned or made subject to a security interest or any other encumbrance. The undertaking is not limited to freedom from consensual security interests; it also applies to security interests or other incumbrances created by law.

D. Protection of assignee's reliance on terms

The interpretation and effect of a contract depends in large measure on the intention of the parties. This could be dangerous for an assignee. The parties might have agreed that a term which has one apparent meaning should have some quite different meaning. As between themselves the true meaning will prevail. The assignee can have no better right than the assignor. So the assignee could also be affected by the secret agreement between the original parties. Paragraph (3) therefore imports an undertaking by the assignor that any terms of a contract or other juridical act which have been disclosed to the assignee as terms regulating the right have not been modified and are not subject to any undisclosed agreement as to their meaning or effect which would be prejudicial to the assignee.

After the assignment has taken effect the assignor is no longer the creditor and would no longer be able to modify the terms regulating the right unless the act of assignment so provides. Modification of the content of the assigned right and the corresponding obligation would be a matter for the debtor and the assignee as the new parties to that legal relationship. Of course, other terms of the contract between the assignor and the debtor could still be modified by agreement between them, provided they did not alter the terms regulating the assigned right.

In some cases an assignment of a contractual right will leave the assignor with no room to modify the contract from which the right arises. The assignor may have performed fully under the contract and may have assigned a simple right to payment. In relation to that right the assignee is the new creditor. Any modification of the amount to be paid or the time of payment would be a matter for agreement between creditor and debtor, that is to say between the assignee and the debtor. In other cases, however, the contract between the assignor and the debtor may remain in effect for many purposes between these two parties. For example, the assignor may still be obliged to perform under it. Clearly a modification of the contract agreed between the assignor and the debtor could indirectly affect the assignee's right. In principle, once contractual rights have been assigned it should not be open to the assignor and the debtor to agree on modifications to the contract under which they arise, unless the assignment agreement so provides or the assignee consents to the modification. This is the main rule under paragraph (4). However, a strict adherence to this principle would cause considerable commercial inconvenience, particularly where the assignment relates to rights under an executory contract involving continuous performance on the part of the assignor, such as a construction contract. For example, in the course of performance of a construction contract circumstances may arise where the parties find it necessary to agree on a variation outside the contractual variation provisions, as where additional work is required that could not have been reasonably anticipated. Again, the modification may be of a part of the contract which has no relevance to the assigned rights. Accordingly the last part of paragraph (4) permits modifications without the assignee's consent where these are made in good faith and are not modifications to which the assignee could reasonably object.

Illustration

C, a building contractor, agrees with D, a bank, to construct a vault for the storage of securities and other valuables belonging to D's customers. Soon afterwards D sells its banking business to E, to whom D assigns its rights under the building contract. In the course of construction it is discovered that a stream, the existence of which is not shown on any drawings relating to the site, flows directly under the floor of the vault and that to prevent the entry of water it is necessary to install an underground pump at considerable additional expense to pump away the water. Though this does not fall within the variation clause of the contract the architect nevertheless considers the installation of the pump unavoidable if the vault is not to be rendered unusable and issues the requisite order to the contractor, indicating that the cost of the pump and labour will be an addition to the contract price. This modification is binding on E even though made without E's consent.

E. No subsequent act which could destroy assignee's priority

The implied undertaking in paragraph (5) – that the assignor will not conclude or grant any subsequent act of assignment of the same right which could lead to another person obtaining priority over the assignee – is necessary because of the later Article which, as between successive apparent assignees of the same right, gives priority to the one who notifies the debtor first. In the absence of such a provision the first assignee would be left without a remedy. The assignor would not be liable for non-performance of the obligation to assign because the debtor would actually have assigned the right and the assignee would have obtained it. The assignee would then however have lost the right because of the operation of the rule on priority. It is obviously right in such circumstances that there should be a remedy against the assignor who has placed the second “assignee” in a position to obtain priority by notification.

F. Transfer of certain security rights

The general rule is that supporting security rights pass with the assignment to the assignee, in so far as they are transferable. They do not require separate assignment. See III.–5:115 (Rights transferred to assignee) paragraph (1). However, there may be situations where something needs to be done by the assignor to effect or complete the transfer. The undertaking in paragraph (5) obliges the assignor to do what is necessary for that purpose. The obligation can be excluded by agreement and applies only to security rights which are transferable. For example, an independent personal security on first demand will normally not be transferable (see IV.G.–3:108 (Transfer of security right)). The assignor can, however, be required to transfer the proceeds (see UCP art. 49).

G. No undertaking that debtor has ability to pay

Paragraph (7) makes it clear that unless otherwise agreed between the assignor and the assignee, the assignor does not undertake that the debtor has, or will have, the ability to pay. This is to counter any arguments that in the case of a sale or security agreement the assigned right would not be fit for its purpose if the debtor could not pay.

H. Other obligations

This Article is not exhaustive of the obligations to the assignee which may be imposed on an assignor. In particular, while it does not import any undertaking that the assignor has no knowledge of any matters casting doubt on the debtor's ability to pay, the general duty to act in accordance with the requirements of good faith and fair dealing may require disclosure of matters known to the assignor indicating that the debtor may be insolvent.

Sub-section 4: Effects of assignment

III.-5:113: New creditor

As soon as the assignment takes place the assignor ceases to be the creditor and the assignee becomes the creditor in relation to the right assigned.

COMMENTS

Once an outright assignment (as opposed to an assignment in security) takes effect the assignee becomes the creditor. The assignor will no longer be the creditor and will therefore not have the right to assign the right to anyone else. The right will not be the assignor's to assign. (If the assignment is by way of security, the assignor has the right to assign further, but that right is correspondingly limited in that there is no right to make a second assignment that will take priority over the first one. Assignments by way of security will be governed by Book IX.) However, a purported second assignment will not be completely ineffective, and in certain circumstances may even take priority over the first one. The rule is that where an assignor has made successive purported assignments, and the second "assignee" did not know of the earlier assignment at the time of the second purported assignment, priority goes to the assignee who first gives notice to the debtor. (See III-5:120 (Competition between successive assignees). This is an exception to the *nemo dat* principle.)

The assignee becomes the creditor in relation to the right assigned – not in relation to some greater or lesser right. The right remains the same before and after the assignment. If, for example, it was a conditional right in the hands of the assignor it remains a conditional right in the hands of the assignee.

Illustration 1

In June a football club X concludes a contract with Y for the provision by Y of stewarding services at a football match which will take place in November (if the team qualifies). The contract provides for an advance payment to be made on 15 October. The contract also provides that all the rights and obligations under it are subject to the resolute condition that they are to cease to have effect if the team fails to qualify. In August Y assigns its rights to payment under the contract to Z.

In September the team fails to qualify. Z has no right to the advance payment due to be made in October. That right was subject to a resolutive condition and has now come to an end. The assignment cannot convert a conditional right into an unconditional right.

It goes without saying that the assignment of a right to performance does not make the assignee the debtor in any corresponding obligation or subject the assignee to any obligation which by law falls on the assignor.

Illustration 2

X sells and assigns to Y a right to a payment under a contract with B. The payment is to be made by B in advance of performance by X. It is to be returned if X does not perform. B is notified of the assignment and makes an advance payment to Y. X does not perform. X has assigned only the right to the payment. X's obligation to repay the amount of the payment has not been transferred. B has a right to repayment from X, not Y.

The above two examples show the importance of careful analysis in cases involving advance payments. In Illustration 1, for example, the position would be the same as in Illustration 2 if the team had failed to qualify after the advance payment had been made on 15 October. The obligation to pay and the corresponding right would have been extinguished by the payment. The right would no longer have been subject to a resolutive condition, although other rights and obligations under the contract would be. Any obligation to repay would have to be based on an implied term of the contract or on the rules regulating the effects of the termination or extinction of rights and obligations. The rules on unjustified enrichment would not apply because the extinction of the relevant rights and obligations would not be retrospective and the payment was not affected by any error or other vitiating factor. Whether the obligation to repay is based on an implied term of the contract or an independent rule of law, it would originally have been an obligation on Y, the assignor, to the debtor and would not have been transferred or extinguished by the assignment of the right.

The general result, that the assignee becomes the new creditor in relation to the right assigned but is not subject to any obligations to repay which fall on the assignor, is important for commercial purposes and particularly for receivables financing. The United Nations Convention on the Assignment of Receivables in International Trade contains a provision (Article 21) to make it clear that failure by the assignor to perform the original contract does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee.

It will be remembered that "right" is defined earlier as including a part of a right. (III.—5:101(Scope of Section) paragraph (3))

III.-5:114: When assignment takes place

(1) An assignment takes place when the requirements of III.-5:104 (Basic requirements) are satisfied, or at such later time as the act of assignment may provide.

(2) However, an assignment of a right which was a future right at the time of the act of assignment is regarded as having taken place when all requirements other than those dependent on the existence of the right were satisfied.

(3) Where the requirements of III.-5:104 (Basic requirements) are satisfied in relation to successive acts of assignment at the same time, the earliest act of assignment takes effect unless it provides otherwise.

COMMENTS

This Article deals with the time an assignment takes place. Again it has to be read along with III.-5:120 (Competition between successive assignees).

A. Assignment of an existing, assignable right by the creditor

Where the right exists and is assignable at the time of an act of assignment by the creditor, the assignment normally takes effect immediately upon conclusion of the contract by which it is assigned or, in the case of an assignment by a unilateral juridical act, at the time when that act is made. (Under the rules in Book II a unilateral juridical act is not made until it is communicated to the person affected by it, in this case the assignee). Of course, this will not apply if the act of assignment itself provides for a later time. It is not necessary that an assigned right to money has become payable; it suffices that it exists as a present right, exigible in the future (*debitum in praesenti, solvendum in futuro*).

Illustration 1

On May 1st C enters into a contract with O to construct a factory at a price of €2 million, payment to be made in instalments against architects' certificates. On June 1st C assigns its rights to A. The first certificate is issued on August 12th. The assignment takes effect on June 1st.

B. Other cases

In other cases the assignment normally takes effect as soon as the requirements are satisfied, unless the act of assignment provides otherwise. If, for example, the right is not in existence or is not assignable at the time of the act of assignment, the assignment will take place when it comes into existence or becomes assignable, unless otherwise provided. Similarly, if the person granting an act of assignment of an existing right is not the creditor, the assignment will take place when that person acquires the right and becomes the creditor, unless otherwise provided.

Illustration 2

S, a timber supplier, enters into a factoring agreement with F by which S agrees to offer for sale to F monthly batches of rights to payment arising from sales of

timber to S's customers. The agreement provides for the sale to take effect as regards any such receivables when the offer relating to them is accepted by F. A batch of receivables is offered to F on May 15th and accepted on May 20th. The assignment of those receivables takes effect on May 20th because that was what was agreed in the act of assignment.

C. Special rule for future rights

The main policy reason behind the rule in paragraph (2) is that in the case of an act of assignment of future rights, the assignee, who will very often have paid for the rights, should be preferred to the creditors of the assignor. Solutions to achieve this policy objective are widely adopted. It follows from the earlier rules that there will be no assignment at all if the future right never comes into existence. The effect of the present provision is that once it has come into existence the assignment can be retrospectively regarded as having taken place when all the other requirements were satisfied. Normally that will mean that the right will be deemed to have been transferred at the time of the act of assignment.

D. Requirements satisfied simultaneously

Paragraph (3) deals with a situation which could arise when a person purports to assign the same right to successive assignees. If the right is not yet in existence or is not yet assignable or if the grantor is not yet the creditor, the requirements for an effective assignment could be satisfied simultaneously for all the assignees. Paragraph (2) provides that in such a case the assignments are treated as being made in the same order as the acts of assignment, unless one of the acts provides that it is only to have effect at some later date (which would be unlikely).

Illustration 3

On September 1st X, a property developer, assigns to Bank Y all its rights under contracts of sale to be entered into in the future with purchasers of the properties currently in course of construction. On October 1st X assigns the same rights to Bank Z. The development is completed the following year and X sells one of the properties to P on 10th August of that year. The assignment of X's right to the price is dependent on the sale but thereupon takes effect in relation to Bank Y, which had the earlier act of assignment.

III.-5:115: Rights transferred to assignee

(1) The assignment of a right to performance transfers to the assignee not only the primary right but also all accessory rights and transferable supporting security rights.

(2) Where the assignment of a right to performance of a contractual obligation is associated with the substitution of the assignee as debtor in respect of any obligation owed by the assignor under the same contract, this Article takes effect subject to III.-5:301 (Transfer of contractual position).

COMMENTS

A. Transfer of primary right

The first effect of an assignment is to transfer the primary right to performance itself. This follows from the definition of an assignment as a transfer. The assignee becomes the new holder of the right, the new creditor, as soon as the assignment takes effect. However, there are later provisions which enable the debtor to obtain a discharge by paying the assignor in good faith at any time prior to the receipt of a notice of assignment. The assignee who does not give notice to the debtor is also liable to be replaced as the new creditor by a second purported assignee who gives notice to the debtor first: see III-5:120 (Competition between successive assignees).

B. Transfer of remedies

An assignment of a right carries with it by implication a transfer of the assignor's right to damages and default interest for future non-performance. This follows from the fact that the assignee is now the holder of the right. Whether the assignment also transfers any rights accrued for past non-performance depends on the terms of the act of assignment.

C. Transfer of accessory rights and supporting security rights

An assignment also operates to transfer all accessory rights (or in the case of a partial assignment a *pro rata* share of those rights) such as contractual rights to interest or rights to call for earlier payment or otherwise modify terms. It transfers accessory rights securing the debtor's performance, for example, dependent personal securities and forms of proprietary security which are considered accessory to the right so as to be discharged when the right is satisfied. In many legal systems the transfer of accessory rights is considered so inherent in an assignment that it cannot be excluded by agreement, for the effect would be to leave the assignor with security for a right no longer vested in the assignor, with the result that neither assignor nor assignee would be able to enforce the security.

However, there are also rights which, though intended to secure performance, are not in terms accessory in character. These supporting security rights are also transferred unless, of course, they are by their nature non-transferable. The policy here is the same as in relation to subrogation in the case of a plurality of debtors or security providers (see III.-4:107 (Recourse between solidary debtors) paragraph (2) and IV.G.-2:113 (Security provider's rights after performance) paragraph (3)). There is no reason why a former creditor (the assignor) should retain a security right the exercise of which would merely constitute an unjustifiable enrichment.

D. Assignment of rights and substitution of assignee as debtor

Where the assignment of rights is associated with an agreement by which the assignee also assumes responsibility, in place of the assignor, for payment of rights incurred by the assignor to the debtor, this Article takes effect subject to III.-5:301 (Transfer of contractual position). That Article is designed to ensure that the assignee cannot obtain

the benefit of the rights assigned before effectively assuming the burdens taken over from the assignor, this requiring the assent of the other party to the contract.

III.-5:116: Effect on defences and rights of set-off

(1) The debtor may invoke against the assignee all substantive and procedural defences to a claim based on the assigned right which the debtor could have invoked against the assignor.

(2) The debtor may not, however, invoke a defence against the assignee:

(a) if the debtor has caused the assignee to believe that there was no such defence; or

(b) if the defence is based on breach by the assignor of a prohibition or restriction on assignment.

(3) The debtor may invoke against the assignee all rights of set-off which would have been available against the assignor in respect of rights against the assignor:

(a) existing at the time when the debtor could no longer obtain a discharge by performing to the assignor; or

(b) closely connected with the assigned right.

COMMENTS

A. Defences

This Article assumes the existence of a valid assignment. If the purported assignment has not taken place (e.g. because the act of assignment is void or ineffective to effect a transfer) the debtor has no obligation to pay or otherwise perform in favour of the purported assignee.

A widely accepted principle, and that adopted in this Article, is that the assignee cannot stand in any better position than the assignor. Accordingly the assignee acquires the rights subject to all defences which the debtor could have asserted against the assignor, and this is so whether the grounds of defence arose before or after the notice of assignment. For this purpose, "defences" includes procedural defences.

Illustration 1

S sells and delivers goods to B and then assigns the seller's rights to A. The goods do not conform to the contract of sale. If A claims the price B has the same defences against A as would have been available against S. So B may be able to terminate for fundamental non-performance and refuse to pay the price to A. Alternatively B can retain them and claim a reduction of the price.

Illustration 2

S contracts to sell goods to B, delivery to be made in one month's time. S then assigns the seller's rights to A but fails to deliver the goods. B can refuse to pay the price to A.

Illustration 3

S agrees to sell goods to B, and then assigns the seller's rights to A. The contract contains a provision that all disputes are to be referred to arbitration. There is a dispute as to the quality of the goods and B refuses to pay A the price. A sues B to recover the price. B is entitled to ask that the dispute be referred to arbitration in accordance with the contract.

B. Assignee incurs no positive contractual liability

The assignee incurs no positive contractual liability to the debtor for non-performance by the assignor. All the debtor can do is to rely on that non-performance as a defence to the assignee's right and to make a separate claim against the assignor.

C. Restrictions

Paragraph (2) contains two restrictions on the debtor's general right to invoke against the assignee any defence which could have been invoked against the assignor. The first - that the debtor cannot invoke a defence if the debtor has led the assignee to believe that there was no such defence - can be regarded as a special application of the principle of good faith and fair dealing in the exercise of rights, remedies and defences. The second - that the debtor cannot invoke any defence based on breach by the assignor of a no-assignment clause - is designed to prevent the rules on no-assignment clauses from being defeated indirectly. The debtor must be prevented from withholding performance from the assignee, or terminating for fundamental non-performance and pleading the fact of termination against the assignee, if the ground for withholding or termination is simply a breach by the assignor of a no-assignment clause.

D. Right of set-off

General. Somewhat different rules apply to set-off. It is generally accepted that the debtor should be allowed to exercise against the assignee the same right of set-off (if any) as the debtor could have invoked against the assignor in respect of cross-rights which exist at the time of receipt of the notice of assignment. In cases where no notice of assignment is given the relevant cut off time should be the time when the debtor can no longer obtain a discharge by performing to the assignor.

Illustration 4

C, who is owed €100,000 by O for the cost of building works, assigns the rights under the building contract to A, who gives notice of the assignment to O. Subsequently O lends C €40,000 under a loan agreement which is unconnected with the building contract. O cannot set off the right for repayment of the loan against the liability to A.

Illustration 5

S sells machinery to B at a price of €1 million payable by five annual instalments of €200,000. By a separate contract S agrees to service the equipment for a period of five years. S assigns all S's rights under these contracts to A. In a claim by A for non-payment of an instalment B can set off a cross-right for damages for loss suffered as the result of S's breach of the servicing contract.

Unmatured obligations. It is not necessary to the right of set-off that the relevant cross-right should have matured at the time of the debtor's receipt of notice of assignment; it suffices that it is in being as a debitum in praesenti, solvendum in futuro. If the rule were otherwise, a debtor's potential right to set off against the creditor a cross-right due to mature at the same time as the creditor's right would be extinguished by the creditor's assignment of the creditor's right, contrary to the fundamental principle that an assignment should not prejudice the debtor. However, under the rules on set-off it is necessary that the cross-right should have matured by the time the debtor is called upon to give performance of the assigned right, for the debtor is not entitled to use set-off to accelerate the cross-right. Once the debtor has received a notice of assignment or is otherwise precluded from obtaining a discharge by performing to the assignor, it would be unfair to the assignee and contrary to principle to allow the assignee's interest to be reduced or extinguished as the result of the debtor setting off independent rights arising from new dealings between the debtor and the assignor. Where, however, those new rights are closely connected with the assigned right, it is reasonable that the assignee should take subject to them.

Illustration 6

In June S supplies goods to B at the price of €10,000, payment to be made on or before 31st December. In August B lends S €4,000 under a loan agreement which requires the loan to be repaid by 1st November. In October S assigns to A the debt of €10,000 due from B, and A gives notice of the assignment to B immediately afterwards and requires B to pay the €10,000 on or before 31st December. B can set off the loan of €4,000 which will by then have become repayable, and it is irrelevant that it had not become repayable when B received the notice of assignment from A.

Illustration 7

The facts are as in Illustration 6 except that the loan of €4,000 is not repayable until 1st February in the following year. On 15th January in that year, following B's failure to pay A the €10,000, A makes demand for payment of that sum. B cannot set off the loan of €4,000, since this has not yet become repayable.

III.-5:117: Effect on place of performance

(1) Where the assigned right relates to an obligation to pay money at a particular place, the assignee may require payment at any place within the same country or, if that country is a Member State of the European Union, at any place within the European

Union, but the assignor is liable to the debtor for any increased costs which the debtor incurs by reason of any change in the place of performance.

(2) Where the assigned right relates to a non-monetary obligation to be performed at a particular place, the assignee may not require performance at any other place.

COMMENTS

A. Effect of assignment on place of performance of money obligation

Where the debtor has to pay the creditor at the latter's place of business or by transfer to the creditor's bank account an assignment of the right necessarily involves a change in the place of performance. Within a given country the place of payment is usually of little significance, since most payments of any significance are made by inter-bank transfer, and it is as easy for the debtor to arrange payment to the assignee's account as to the assignor's account. Rather different considerations may apply where the place of payment is changed to one in a different country. Apart from increased costs, which the debtor is entitled to recover from the assignor under paragraph (1) of this Article, the debtor may be affected by currency controls, increased transfer risks and the need to allow greater time for the transfer to be effected. Hence the general rule stated in paragraph (1) that the assignee may not require payment in a country different from that of the place where payment is due. However, this rule is modified where the original place of payment is in a Member State of the European Union, in which case the assignee may require payment to be made either in that State or in any other Member State. In effect, the European Union is treated as a single country for the purpose of paragraph (1) of this Article. This reflects the concept of the European Union as a single market and the advent of the European Monetary Union and the Euro as the obligatory common currency of Member States of the EMU. This rule goes beyond what is found in any of the national laws but is convenient in the context of a single market.

Illustration 1

S in Hamburg sells goods to B in Paris, payment to be made by inter-bank transfer to the credit of S's account with its bank in Hamburg. S assigns the debt to A in Milan. On giving notice of the assignment A can require B to make payment to the credit of A's account in Milan.

Illustration 2

The facts are as in Illustration 1 except that S is in New York and B is required to make payment to S in New York. A, the assignee in Milan, can require B to pay anywhere in the United States but not in any other country.

B. Place of performance of non-monetary obligations cannot be changed

Non-monetary obligations raise quite different considerations, since a change to a new place of performance even within the same country may fundamentally alter the nature of the obligation. For example, where there is a contractual obligation to ship goods f.o.b. Southampton, the place of shipment is an essential term of the contract and the obligation ought not, by reason of an assignment, to be converted into an obligation to ship f.o.b. Liverpool. Accordingly paragraph (2) provides that the assignee of a right to the performance of a non-monetary obligation cannot change the place of the debtor's performance.

Sub-section 5: Protection of debtor

III.-5:118: Performance to person who is not the creditor

(1) The debtor is discharged by performing to the assignor so long as the debtor has not received a notice of assignment from either the assignor or the assignee and does not know that the assignor is no longer entitled to receive performance.

(2) Notwithstanding that the person identified as the assignee in a notice of assignment is not the creditor, the debtor is discharged by performing in good faith to that person.

COMMENTS

A. General

This Article sets out the ways in which the debtor can obtain a discharge when the right has been assigned. It is in addition to the special rules in III.-5:108 (Assignability: effect of contractual prohibition) allowing the debtor, subject to certain exceptions, to obtain a good discharge by paying the assignor where the assignment has taken place in breach of a contractual prohibition or restriction. It is clearly necessary to have provisions for the protection of the debtor if notice to the debtor is not a requirement for an effective assignment. The debtor must be given the means of knowing to whom performance is to be made (a matter developed further in the next Article) and must be protected if performance has been made in good faith to the wrong person.

B. Performance to creditor

It goes without saying that the debtor will always be discharged by performing to the person who is for the time being the creditor. Performance to the creditor extinguishes the obligation.

C. Performance to assignor before receipt of notice of assignment

Paragraph (1) provides that the debtor is discharged by performing to the assignor so long as the debtor has not received a notice of assignment from either the assignor or the assignee and does not know that the assignor is no longer entitled to receive payment. The debtor would not necessarily lose this protection merely because the debtor knew from some other source that the right had been assigned. It is not uncommon for a right to be assigned but for the understanding between assignor and assignee to be that the assignment will not be notified and that the assignee will continue to receive payments.

There is no requirement that the notice of assignment must be in any particular form. However, the next Article enables the debtor to request adequate proof of the assignment in any case of doubt and to withhold performance until it is provided. The notice may be given either by the assignor or by the assignee, but in the latter case the next Article enables the debtor to request the assignee to provide reliable evidence of the making of the assignment.

The law on unjustified enrichment protects the assignee in any case where the debtor obtains a discharge under this provision by performing to the assignor. The debtor will have paid to a person who is no longer the creditor. The assignor is enriched without legal justification. The assignee suffers a corresponding disadvantage because the assignee can no longer recover from the debtor. So the assignee can recover from the assignor whatever has been paid or transferred by the debtor in performance of the obligation.

D. Performance to person identified as assignee in notice of assignment

Where the debtor receives a notice of the assignment the debtor should be entitled to rely on it and to obtain a discharge by performing in good faith to the person named as assignee in it. The debtor would not be in good faith if there was reason to suppose that the notice of assignment was sent by a fraudster. The debtor would also not be in good faith if the debtor knew that the assignment was ineffective because the right was non-assignable by law. In cases of genuine doubt the debtor could request further particulars or evidence under the following Article and in the meantime withhold performance.

Again the law on unjustified enrichment comes into play in this situation. The debtor has obtained a discharge by performing to the wrong person. The person wrongly identified as the assignee has been enriched without legal justification. The assignor has suffered a corresponding disadvantage because no longer able to recover from the debtor. So the assignor can recover from the supposed assignee under the law on unjustified enrichment.

III.-5:119: Adequate proof of assignment

(1) A debtor who believes on reasonable grounds that the right has been assigned but who has not received a notice of assignment, may request the person who is believed to have assigned the right to provide a notice of assignment or a confirmation that the right has not been assigned or that the assignor is still entitled to receive payment.

(2) A debtor who has received a notice of assignment which is not in textual form on a durable medium or which does not give adequate information about the assigned right or the name and address of the assignee may request the person giving the notice to provide a new notice which satisfies these requirements.

(3) A debtor who has received a notice of assignment from the assignee but not from the assignor may request the assignee to provide reliable evidence of the assignment. Reliable evidence includes, but is not limited to, any statement in textual form on a durable medium emanating from the assignor indicating that the right has been assigned.

(4) A debtor who has made a request under this Article may withhold performance until the request is met.

COMMENTS

A. General

This Article is designed to protect a debtor in various situations of uncertainty.

B. Assignment but no notice

The first situation in which the debtor needs protection is where the debtor has reason to believe that there has been an assignment but has not received any notice of assignment. In such a case the debtor cannot safely perform to the assignee and indeed may not even know who the assignee is. However, the debtor may fear that performance to the assignor might also be unsafe. Paragraph (1) enables the debtor to ask the assignor to clarify the situation by providing a notice of assignment or a confirmation that the right has not been assigned or that the assignor is still entitled to receive payment. Until the position is clarified the debtor can withhold performance. The debtor would, however, not be able to rely on this right if acting contrary to the requirements of good faith and fair dealing – for example, if the debtor did not believe that the right had been assigned and was just adopting a delaying tactic.

Illustration 1

C assigns to A a right to payment by D. Neither C nor A gives notice of the assignment but D learns of it from another source. If D is confident that the right has been assigned to A then D may pay A and will be discharged. If D is not confident then D can ask C to clarify the position and in the meantime may withhold payment.

C. Inadequate or unclear notice

The next situation where the debtor needs protection is where a notice of assignment has been received but it is not in textual form or does not give enough information to enable the debtor to be able to perform to the assignee. In such a case the debtor may, under paragraph (2), ask the person who gave the notice to provide a new notice in textual form which contains adequate information. Again the debtor may withhold performance until the request is met. Again the debtor would not be able to rely on this right if acting contrary to the requirements of good faith and fair dealing.

D. Notice received from assignee

The notice may be in textual form and adequate on its face. However, if it is given by the assignee the debtor may have reason to doubt whether it is genuine. Paragraph (3) enables the debtor to ask the assignee to provide reliable evidence of the making of the assignment. This would include any document emanating from the assignor and indicating that the assignment has taken place. The debtor is entitled to withhold performance until the evidence is furnished.

Illustration 2

C orally assigns to A a debt due from D. A gives notice of the assignment to D but fails to respond when D requests evidence of the assignment. D may either pay A, in which case D obtains a discharge from liability, or withhold performance until A has provided reliable evidence of the making of the assignment.

Sub-section 6: Priority

III.-5:120: Competition between successive assignees

(1) Where there are successive purported assignments by the same person of the same right to performance the purported assignee whose assignment is first notified to the debtor has priority over any earlier assignee if at the time of the later assignment the assignee under that assignment neither knew nor could reasonably be expected to have known of the earlier assignment.

(2) The debtor is discharged by paying the first to notify even if aware of competing demands.

COMMENTS

A. General effects

The assignor may have purported to assign the same right to two or more assignees, whether dishonestly or because the first assignment is by way of security only and is for a

debt substantially below the value of the assigned rights, so that there is scope for one or more further assignments.

The first general effect of this Article is to displace the normal rule, which would apply by virtue of the preceding Articles, that the first assignment to take effect would result in the right being transferred to the assignee under that assignment. The assignor would then have no right to assign so that subsequent purported assignees would take nothing. The effect of this Article is that in this special situation the normal rule is replaced by a rule giving priority according to the time of notification to the debtor. The effect of giving priority to a particular assignment depends on whether it is absolute or by way of security. If it is absolute then the competing interest is extinguished; if it is only by way of security, the competing interest is merely subordinated, and where the secured obligation is discharged the competing interest becomes effective.

The second general effect is that the debtor will be discharged by paying the first purported assignee to notify even if the debtor is aware of the competing demands and even if the first to notify was aware, or could reasonably be expected to have been aware, of the earlier assignment. The debtor cannot be expected to investigate questions of good faith on the part of successive purported assignees. The earlier purported assignee will not have a right to recover from the one who is the first to notify (assuming that the notification is made in good faith and in ignorance of the prior assignment) because, by virtue of this Article, the one who is the first to notify is in this situation regarded as the assignee. The debtor will have paid to the true creditor. The earlier purported assignee will have a remedy against the assignor for breach of the implied undertaking not to conclude or grant a subsequent act of assignment which could lead to another person obtaining priority. If, however, the first notifier knew or ought to have known of the earlier assignment then the earlier assignee will be able to recover from the first notifier on principles of unjustified enrichment. In that situation the debtor will have obtained a discharge by paying a person who was not the creditor.

B. The first-to-notify rule

Legal systems differ in their approach to competing assignments. In some systems the principle *nemo dat quod non habet* is applied. Having made the first assignment, the creditor has nothing left to assign. Accordingly the second assignment is ineffective, and while the debtor obtains a good discharge by giving performance to the second assignee without knowledge of the first assignment, the second assignee is required to account to the first assignee for any performance received. Other legal systems give priority to the second assignee who neither knew nor ought to have known of the prior assignment if the second assignee's assignment is the first to be notified to the debtor (whether by that assignee or by the assignor). This latter approach is that adopted here. It reflects two distinct ideas. The first is that giving notice of assignment in good faith is the closest equivalent to the acquiring of possession in good faith, which is a recognised method of obtaining priority in the case of tangible movables. The second is that an intending assignee, before giving value, can ask the debtor whether the debtor has received any prior notice of assignment. If the first assignee has failed to give such a notice the second

assignee should be entitled to assume that there is no earlier assignment, unless the second assignee has acquired knowledge of the earlier assignment in some other way or ought to have known of the earlier assignment, e.g. because it had been registered in a public register.

Illustration 1

S assigns to A1 a debt due from D and then purports to assign the same debt to A2, who is the first to give notice of assignment to D. If A2 neither knew nor ought to have known of the prior assignment at the time of taking A2's own assignment, A2 has priority. This is the case whether the assignments or either of them were outright transfers or were transfers by way of security only. However, if the assignment to A2 is outright, A1's rights are not merely subordinated but extinguished.

C. Neither party notifies

Where neither party has given notice of assignment, the ordinary rule *qui prior est tempore potior est jure* applies. However, the priority of the first assignee is provisional only, being liable to be displaced if the second assignee, being unaware of the earlier assignment, gives notice of assignment before such a notice has been given by the first assignee.

Section 2: Substitution of new debtor

III.-5:201: Substitution: general rules

(1) A third person may undertake with the agreement of the debtor and the creditor to be substituted as debtor, with the effect that the original debtor is discharged.

(2) A creditor may agree in advance to a future substitution. In such a case the substitution takes effect only when the creditor is given notice by the new debtor of the agreement between the new and the original debtor.

COMMENTS

A. Scope

This Article deals only with the substitution of a new debtor for the original debtor, with the effect of discharging the original debtor. The addition of a new debtor to the original one is not dealt with by any specific rule, because no peculiar problems occur when a contractual agreement is made by which a third person joins a debtor in an existing obligation. In such a case the result is to create a plurality of debtors, a topic dealt with in the Chapter on this topic.

B. The concept of substitution

It is a widely accepted principle that a person (the “third person” or “new debtor”) may accept the debt of another person (the “debtor” or “original debtor”), thereby being substituted for the debtor.

An agreement between the third person and the debtor cannot by itself have the effect of discharging the debtor from the obligation to the creditor. To achieve that result the creditor has to assent to the substitution.

There is no uniform answer in the different European legal systems to the question whether the debtor’s assent is necessary for the substitutionary effect of an agreement between the third person and the creditor aimed at the substitution of the third person for the debtor. Under the present Article an agreement between the third party and the creditor does not bring a substitution into operation unless the debtor also agrees. This does not, of course, prevent the creditor from unilaterally releasing the debtor in accordance with the applicable national rules on waiving or renouncing rights but in such a case there would be two separate juridical acts - a contract between the creditor and the third person and a separate release by the creditor - rather than a single juridical act of substitution under the Article.

C. Relationship to other concepts

Assignment. Substitution is to some extent the antithesis of assignment. Assignment results in a new creditor. Substitution results in a new debtor. Assignment, however, does not require the agreement of all three parties.

Novation. “Novation” is used in different senses in different legal systems. Generally it means the replacement of a contract by a new contract, often between the same parties. Substitution under the present Article, on the other hand, involves a change in the debtor, the contract remaining in force and unchanged in other respects.

Stipulation in favour of a third party. A stipulation in favour of a third party, as regulated in these rules, is effected by the contract between the two original parties, who both remain parties to the contractual relationship. The substitution of a new debtor is effected by a new agreement between all three parties and involves the replacement of the original debtor.

Performance by a third person. The rules on performance by a third person do not involve a change in the person of the debtor. They simply provide an answer to the question whether performance by a third person may qualify as “due performance” which cannot be refused by the creditor.

D. Importance of creditor's agreement

The wording of paragraph (1) makes it clear that the creditor's agreement to the substitution is essential to create the effects of substitution. Often the substitution will be based on an initial agreement between the debtor and the third person, to which the creditor's assent is required if the debtor is to be discharged.

The declaration of assent need not be express, but it must be definite and unequivocal. As long as the creditor's assent has not been declared, the agreement cannot have the effect that the debtor is replaced by the third party. Otherwise, the creditor would bear the great and unacceptable risk of being forced to accept a debtor who might be less solvent, less trustworthy or less reliable than the original debtor.

Illustration 1

A has borrowed €100,000 from Bank B. Shortly thereafter C buys a building from A for a price of €120,000 and agrees with A to take over, in part payment, A's debt to Bank B thereby replacing A as debtor. B declares its assent to this agreement. As a result, C is substituted for A as debtor to B.

If the creditor does not assent to the agreement between the original debtor and the third person, the agreement has legal effects only between the debtor and that person. This does not mean, however, that the third person automatically joins the debtor in the obligation to the creditor, so as to give the creditor a right to require performance from either. Whether the creditor acquires a right against the incoming person will depend primarily on the terms of the contract between the debtor and that person. The rules on stipulations in favour of a third party will apply, the creditor being a third party in relation to the agreement in question.

Paragraph (2) makes it clear that assent may be given in advance by the creditor. In this case, the substitution will take effect only after the original debtor and the new debtor have reached agreement and the new debtor has notified the creditor of it. Since the creditor must know whether and when the substitution will take effect, the requirement that the creditor receives notice is not limited to cases where the new debtor has not yet been identified at the time of the advance assent.

Illustration 2

A is about to sell a building to C, but urgently needs a loan from Bank B. A asks Bank B to agree in advance to C taking over responsibility for repayment of the loan as from the conclusion of the contract of sale of the building. B agrees. C later agrees also and notifies B accordingly. As from the moment when the contract of sale is concluded, C is substituted for A as the debtor.

E. Matters left to implication

The Article does not provide expressly for the substitution of a new debtor in relation to only part of the obligations under the contract. This, however, is not excluded by the Article and if the obligations are divisible substitution may take place in relation to any

part of them identifiable as a separate obligation. As the creditor must agree to the substitution there is no need for any equivalent of the special protection afforded by III – 5:107 (Assignability in part) in the case of partial assignments.

The Article does not contain any formal requirements for an agreement substituting a new debtor for the original debtor. It follows that, in accordance with the general rules on contracts and other juridical acts, there are no formal requirements.

III.–5:202: Effects of substitution on defences and securities

(1) The new debtor cannot invoke against the creditor any rights or defences arising from the relationship between the new debtor and the original debtor.

(2) The discharge of the original debtor also extends to any security of the original debtor given to the creditor for the performance of the obligation, unless the security is over an asset which is transferred to the new debtor as part of a transaction between the original and the new debtor.

(3) Upon discharge of the original debtor, a security granted by any person other than the new debtor for the performance of the obligation is released, unless that other person agrees that it should continue to be available to the creditor.

(4) The new debtor may invoke against the creditor all defences which the original debtor could have invoked against the creditor.

COMMENTS

A. General effect of substitution

The mere transfer of the debt to a new debtor does not change the content of the obligation. In contrast to “novation”, in its traditional meaning within the civil law tradition, the content of the debt is not affected by the substitution of a new debtor for the original debtor but remains unchanged. What is transferred to the new debtor is the original debt with the same content and accessory rights (for instance, the right to interest) as existed before.

However, any real or personal security for the debt granted by a person who is not a party to the contractual relationship between the original debtor, the new debtor, and the creditor is released upon the discharge of the original debtor. If, however, the person having granted the security agrees that it should not be affected by the change in the person of the debtor, the security will remain effective.

Accessory rights which the creditor may have against the debtor remain available to the creditor and are not affected by the substitution. If the new debtor had granted a security to the creditor before agreeing to be substituted as debtor, that security will continue to be

available to the creditor, who may also take advantage of any additional securities provided by the new debtor on or after that time.

B. Effect on defences stemming from the agreement for substitution

Paragraph (1) makes it clear that the creditor is not affected by any rights or defences which the third person may derive from that person's agreement with the debtor. Even a defect in the agreement for substitution between the original debtor and the new debtor that would make it void or voidable does not change the position of the new debtor in relation to the creditor. The creditor is entitled to proceed against the new debtor even if the creditor knew or could reasonably be expected to have known that the relationship between the original debtor and the new debtor is defective because it lacks consent of the parties, or is of such a kind as would allow the new debtor to raise a defence against the original debtor. The substitution is to this extent regarded as being "abstract" – independent of defects in the underlying relationship between the original debtor and the new debtor. The policy is to protect the creditor. The creditor should not be concerned with defects in the legal relationship between the original debtor and the new debtor.

Illustration

A sells to C an alleged original piece of medieval Chinese art for €20,000 and agrees with C that in exchange C should be substituted for A as debtor of Bank B. Upon notification by A, Bank B declares its assent to the substitution. Soon thereafter it becomes evident that A – who has meanwhile gone bankrupt – had sold a fake to C. This does not affect the substitution.

C. Discharge of the original debtor and of third persons with regard to securities

Under paragraph (2) the original debtor who has granted a security for the performance of the obligation is generally discharged with regard to that security, as soon as the substitution takes effect. Under paragraph (3), any third person who has granted a security for the performance of the obligation by the original debtor is also, as a rule, released. These rules are to be found in a clear majority of European legal systems.

There are however exceptions to these rules. With regard to securities granted by the original debtor the rule does not apply to any security over an asset which is transferred as part of a transaction between the original debtor and the third person stepping in as new debtor. This may have practical importance in the case of a reservation of title clause in respect of goods, for which part of the price had been owed to the creditor by the original debtor.

With regard to securities, such as surety and pledge, granted by any other person for the performance of the debt, this other person may agree to the continuation of the security in favour of the creditor, but will be released in the absence of any such agreement.

D. Defences stemming from the original debt

The substitution of a new debtor for the original debtor means that the new debtor is put into the same legal position as the original debtor. The new debtor may therefore set up – with certain exceptions – all the substantive and procedural defences against the creditor which the original debtor would have had in relation to the original contract with the creditor. This applies, for example, with regard to the defence of prescription.

The crucial moment for setting up a defence is the moment of conclusion of the agreement by which the new debtor is substituted for the original debtor. All the objections the original debtor might have been able to raise prior to this time, or based on events which had taken place by this time, may be raised by the new debtor. Defences that became available to the original debtor at a time when the substitution had already been effected cannot be raised by the new debtor.

The new debtor cannot, however, use the original debtor's right in order to effect set-off, since this goes beyond utilising a defence and, as a rule, the new debtor is not entitled to dispose of such a right without the assent of the original debtor.

There are certain exceptions to the rule that the new debtor may raise the defences of the original debtor. In particular, this rule will not apply whenever the new debtor has accepted an obligation that existed independently from the original debt. Neither can the new debtor set up any defences against the creditor that stem from the contractual relationship between the original debtor and the new debtor.

Section 3: Transfer of contractual position

III.–5:301: Transfer of contractual position

(1) A party to a contractual relationship may agree with a third person that that person is to be substituted as a party to the relationship. In such a case the substitution takes effect only where, as a result of the other party's assent, the first party is discharged.

(2) To the extent that the substitution of the third person involves a transfer of rights, the provisions of Section 1 of this Chapter apply; to the extent that obligations are transferred, the provisions of Section 2 of this Chapter apply.

COMMENTS

A. General Remarks

Whereas an assignment is limited to the transfer of rights to performance and a substitution of a new debtor for the original debtor concerns only a change in the person

owing a debt, the present article deals with the transfer of the entirety of contractual rights and obligations from a contracting party to a third person. Given that contracts of long duration, and take-overs or amalgamations of businesses, are common in Europe, the rules on transfer of an entire contract are of great practical importance.

Agreements for the transfer of contracts are often concluded with regard to tenancy agreements, loan arrangements, labour contracts and other types of contract of long duration.

The transfer of an entire contract must not be confused with novation. Novation implies the extinction of the old contractual relationship and the constitution of a new one with a different object or a different source, whereas in a transfer of the contract the relationship remains the same. The contractual bond is the same, but it is transferred from the first party to the incoming third party.

B. Substitution of a party in respect of the entire contractual relationship

Either party to a contract can, with the necessary agreement of the other, substitute a third person in the entire relationship arising from a contract, so that the third person assumes both the benefit and the burden of the contract in place of the first party. The third person takes over both the first party's right to performance and the first party's contractual duties to perform.

Illustration 1

A concludes a contract for the construction of a prefabricated house with Company B for a certain price and pays a first instalment. B becomes bankrupt soon thereafter. Provided A agrees, Company C may step into the contract in place of B with all the contractual rights and obligations which were previously B's.

C. The importance of the other party's assent

For the first party to be released from all obligations to the other contracting party that other party's assent is necessary. This assent may be given in advance, a situation which is common and important in practice.

If the other party does not assent, the transfer has no effect. Neither obligations nor rights will be transferred. Of course it would then often be possible for the first party (a) to assign rights to the third party (which would not require the other party's consent) and (b) to entrust the performance of duties to the other party. But the latter would only be effective in accordance with III.-2:106 (Performance entrusted to another) and the original party would remain responsible for proper performance of the obligations.

D. Applicability of rules on assignment and substitution

A transfer of the contract is more than a mere combination of assignment of rights and substitution of a new debtor. It is a uniform transaction, transferring a whole structure of rights, legal positions, and duties, which can appropriately be regarded as more than a mere combination of single acts transferring rights and duties. In practice, however, the result of such a transaction is the transfer of all contractual rights including collateral ones, as well as the acceptance of all contractual obligations by the incoming party.

That explains why the Articles on assignment and substitution of a new debtor apply with any appropriate adaptations. Thus, accessory rights are to be treated in the same way as provided by III.–5:115 ((Rights transferred to assignee) paragraph (1) in the context of assignment. Notice by the new party is required for the transfer of the contract to take effect when the other party's assent has been given in advance (as in III.–5:201 (Substitution: general rules) paragraph (2)) and the incoming party cannot invoke against the other party any rights or defences that are based on the incoming party's relationship with the replaced party (as in III. 5:202 (Effects of substitution on defences and securities) paragraph (1)).

CHAPTER 6: SET-OFF AND MERGER

Section 1: Set-off

III.–6:101: Definitions

(1) “Set-off” is the process by which a debtor may reduce the amount owed to the creditor by an amount owed to the debtor by the creditor.

(2) In this Chapter, “right” means a right to performance of an obligation, unless the context otherwise requires.

COMMENTS

A. Nature of set-off

In these rules set-off is regarded as a matter of substantive law rather than as a purely procedural device. If the requirements for set-off are met, and if set-off has been declared, the obligations confronting each other are extinguished. Thus, if either of the parties subsequently sues the other, the action will have to be dismissed as unfounded since the right on which it is based no longer exists. There is one exception to this rule which is spelt out in III.–6:103 (Unascertained rights).

If a debtor declares set-off in the course of legal proceedings, it will have to be determined, under the rules of civil procedure applicable to the proceedings, whether such a plea is admissible. If it is, the set-off is immediately effective on the level of substantive law and the fact that the obligations have been extinguished has to be taken into account in deciding the dispute (unless III.–6:103 (Unascertained rights) applies). If it is not, the debtor may still assert the right outside the proceedings.

B. Definition of “right”

As in the preceding Chapter, “right” in this Chapter means a right to performance of an obligation unless the context otherwise requires.

III.–6:102: Requirements for set-off

If two parties owe each other obligations of the same kind, either party may set off that party’s right against the other party’s right, if and to the extent that, at the time of set-off, the first party:

- (a) is entitled to effect performance; and*
- (b) may demand the other party’s performance.*

COMMENTS

A. Requirements for set-off

Set-off has four requirements.

Mutuality. The rights must exist between the same parties. There must, in the traditional formulation, be *concursum debiti et crediti*. So, for example, a security provider who has a personal right against the creditor cannot set off that right against the creditor’s right against the main debtor. It follows from the requirement of mutuality that there can be no set-off between a debt owed by a person (P) as an individual and one due to that person as a representative or fiduciary. P owes the first debt but the other debt is regarded as being owed, not to P, but to the person on whose behalf or for whose benefit P is acting. A commonly adopted way of expressing this idea is to say that the rights must exist between the same parties in the same capacity or in the same right.

There is one exception to the rule of mutuality. Where a right has been assigned, the debtor can assert against the assignee certain rights of set-off which would have been available to the debtor against the assignor. This is expressly allowed by a provision in the rules on assignment (III.–5:116 (Effect on defences and rights of set-off) paragraph (3)). It is justified by the need to protect the debtor.

Obligations of the same kind. Both obligations must be of the same kind: a money right can be set off only against a money right, a right for the delivery of grain only against a right for the delivery of grain of the same kind. Set-off usually relates to monetary

obligations; the prime example of non-monetary obligations, to which set-off may be relevant today, are securities, whether certificated or dematerialised. Whether rights are of the same kind depends on their state at the time that notice of set-off is given. Set-off concerning foreign currency debts - the most important practical question in this context - is dealt with in III.-6:104 (Foreign currency set-off).

Cross-right due. Since set-off constitutes a form of enforcement of the cross-right (i.e. the right of the party declaring set-off), the cross-right has to be enforceable. Thus, it has to be due, the other party must not be able to raise a defence, and the cross-right must not relate to a *naturalis obligatio* (i.e. an obligation which is not enforceable but which allows the recipient to retain performance once it has been effected). However, as far as prescription of the cross-right is concerned, see III.-7:503 (Effect on set-off).

Illustration 1

A has a right against B for €100 which arises from the sale of kitchen equipment and which has become due on 10 October. B wishes to effect set-off with a right against A. B's right (i.e. the cross-right) is based on a loan, repayment of which is due on 20 October. Before 20 October B may not declare set-off. After 20 October B may still not effect set-off if A has a defence against B's right. The same applies if B tries to set off an unenforceable right such as, in some legal systems, one arising from gambling.

Party declaring set-off entitled to perform. The principal right (i.e. the right against the person declaring set-off) does not necessarily have to be due; it is sufficient that the person declaring set-off is entitled to effect performance. For as soon as a debtor may thrust performance on the creditor (which may be long before the right falls due) there is no reason not to allow the debtor to declare set-off. A debtor who is not yet entitled to effect performance, however, may not declare set-off. Set-off is also excluded if the debtor may no longer perform because the principal right has become subject to an order of attachment.

Illustration 2

A has a right against B, due on 10 October. B has a right against A, due on 10 September. While A is not entitled to declare set-off before 10 October, B may do so as from 10 September, provided that B is entitled to render performance in favour of A as from that date.

Illustration 3

A has invested a sum of €10,000 with B, the money being repayable on 10 October. The parties have fixed an interest rate of 10 %. A still owes B €10,000 arising from a contract of sale concerning B's car. B had transferred the car on 1 August and on the same day A's obligation to effect payment had become due. Nevertheless, B may not give notice of set-off before 10 October since A may decline to receive back the sum invested with B before 10 October.

B. Unascertained cross-right

It is not always a requirement for set-off that the cross-right is ascertained as to its existence or its value; see the rule in III.–6:103 (Unascertained rights).

C. Obligations to be performed at different places

Set-off is not excluded by the fact that the obligations have to be performed at different places (e.g. loan repayable at the lender's place of business to be set off against a right to payment of a purchase price which has to be paid at the seller's place of business. Allowing set-off in this type of situation is unlikely to cause any prejudice to the creditor of the principal right.

D. Insolvency set-off

The rules in this chapter are not intended to deal with set-off in insolvency. Special rules provided by the applicable national insolvency laws prevail.

III.–6:103: Unascertained rights

(1) A debtor may not set off a right which is unascertained as to its existence or value unless the set-off will not prejudice the interests of the creditor.

(2) Where the rights of both parties arise from the same legal relationship it is presumed that the creditor's interests will not be prejudiced.

COMMENTS

A. The options

There is an obvious danger that a debtor may protract legal proceedings by invoking set-off on account of a dubious cross-right such as one which cannot easily be proved or the existence of which is as yet uncertain, and there is thus the necessity of affording some protection to the creditor. This can be done in one of three ways.

Cross-right must be ascertained. The fact that the cross-right is ascertained ("liquidity") could be elevated to a fifth substantive requirement of set-off. But this would go too far. There may be cases where set-off would not prejudice the other party and would be entirely appropriate. It may, for example, be clear that the value of the cross-right will be ascertained within the period which legal proceedings involving the principal right will take anyway. Or it may be certain that the cross-right exceeds the value of the principal right. A substantive requirement of liquidity, without any discretion on the part of the judge, would inhibit unnecessarily the possibility of set-off.

Cross-right need not be ascertained. Alternatively, a legal system may take the view that, on the level of substantive law, set-off is not prevented by the fact that the cross-right is unascertained. For practical reasons such a solution would normally be

accompanied by provisions requiring the judge to refuse to consider set-off if this would unduly protract the proceedings. Typically, therefore, there would be a procedural provision allowing the judge to deal separately with principal right and cross-right and to give a provisional judgment on the principal right. But this solution would appear to be awkward, and somewhat impractical, in that a creditor who wants to enforce the provisional judgment would run the risk that this step may later turn out not to have been based on a valid title, with the consequence that the creditor might have to repay the amount obtained and pay damages. The creditor, in other words, does not really have a secure and useful title yet - a point which is hardly likely to prompt the debtor to tender payment.

Judicial discretion. The Article therefore adopts a third approach which can, essentially, be regarded as a compromise between the first two. If the cross-right cannot be readily ascertained, the judge is empowered to adjudicate upon the principal right without taking account of the set-off declared by the debtor, provided that the principal right is otherwise ready for adjudication. The judge is thus given a discretion and will have to take account of all the circumstances of the case, such as the probable duration of the proceedings concerning both principal right and cross-right, or the effect of a delay on the creditor. In the exercise of this discretion, the judge will, however, have to distinguish two cases. (a) If principal right and cross-right arise from the same legal relationship, the judge will not normally deal only with the principal right but will deal also with the cross-right and consider the issue of set-off. The Article establishes a factual presumption that the interests of the creditor of the principal right are not normally prejudiced in this situation. (b) If principal right and cross-right do not arise from the same relationship, the decision will normally go the other way: Commercial predictability and fairness demand that a party who has an ascertained right should not be held up in pursuing this right. If the judge decides to adjudicate upon the principal right, the judgment is not merely of a provisional nature. The decision rests solely on the merits of the creditor's claim which the judge regards as being unaffected by the declaration of set-off. As a result, the declaration of set-off must be regarded as ineffective. The debtor's right will therefore have to be pursued independently.

B. Right to withhold performance

The problems analysed above do not arise in situations where the debtor can make use of a right to withhold performance in terms. In these cases the (principal) right is not ready for adjudication.

III.-6:104: Foreign currency set-off

Where parties owe each other money in different currencies, each party may set off that party's right against the other party's right, unless the parties have agreed that the party declaring set-off is to pay exclusively in a specified currency.

COMMENTS

A. Set-off not prevented

It is doubtful whether debts in different currencies are "of the same kind" and whether they may thus be set off against each other. The present Article takes its lead from Art. 8 (6) of the EU-Regulation on the Introduction of the Euro, no. 974/98 of 3 May 1998 (OJEC 1998, 139/1) which came into force on 1 January 1999. In terms of this regulation, the Euro has become the uniform denomination for those countries that have joined the monetary union. For a transitional period (until 31 December 2001) the former national currencies were regarded as sub-units of the Euro. As a result, set-off was no longer prevented, within the Euro-zone, as a result of the fact that the obligations were expressed in different currencies. This should also be the rule with respect to other currencies. It is in line with the modern view increasingly adopted in the national legal systems since it facilitates set-off without unduly prejudicing the reasonable interests of the creditor of the principal right. The free availability of foreign currency set-off may possibly encourage speculation on fluctuation of the money markets. However, this very fact will normally induce the party most likely to lose out as a result of such fluctuation to give notice of set-off as soon as possible. Since 1 January 2002 the issue of conversion no longer arises within the Euro-zone.

Illustration

A has to pay B a sum of £10,000 for the delivery of a machine. Payment is due on 10 October. On 20 October a right of A against B for payment of €40,000 arising under a loan agreement becomes due. As from 20 October (i.e. the due date of the cross-right), A may effect set-off by giving notice of set-off to B.

B. Exchange rate

Article 8(6) of the Euro Regulation states that any conversion has to be effected "at the conversion rates". "Conversion rate" is defined in Article 1 of the Regulation as "the irrevocably fixed conversion rate adopted for the currency of each participating Member State by the Council according to Article 109 I (4) first sentence (now Art. 123(4) first sentence) of the EC-Treaty". As far as other currencies are concerned, the rate of exchange to be applied should be the unified rate if there is such rate; if not, it should be the buying rate for the currency of the right against which set-off is declared.

III.-6:105: Set-off by notice

The right of set-off is exercised by notice to the other party.

COMMENTS

A. The requirement of notice

An informal, unilateral, extrajudicial declaration to the other party is sufficient to declare set-off. If the matter subsequently comes to court, the judgment has a merely declaratory effect: it does not bring about the set-off but merely confirms that it has been brought about. Since a declaration of set-off has the effect of discharging the two obligations as far as they are coextensive (III.–6:107 (Effect of set-off)), it has a direct impact on the legal relationship between the parties. Like other such unilateral rights to alter a legal relationship it cannot be subjected to a condition or time clause (*dies*). Thus, in particular, it is not possible for a debtor, if all requirements for set-off are met, to declare set-off as from some future date (deferred set-off). On the other hand, however, a debtor whose right is not yet due may declare set-off, but such declaration only takes effect when the right has become due (declaring set-off early).

B. Set-off by agreement

It goes without saying that the parties may, alternatively, effect set-off by agreement. This follows from the general recognition of freedom of contract. In the case of set-off by agreement the parties may derogate from the normal requirements for set-off. Usually, in fact, the parties resort to set-off by agreement if one or other of the normal requirements for set-off is not met. An agreement for a current account implies that the debits and credits will be set off against each other at each balancing of the account.

III.–6:106: Two or more rights and obligations

(1) Where the party giving notice of set-off has two or more rights against the other party, the notice is effective only if it identifies the right to which it relates.

(2) Where the party giving notice of set-off has to perform two or more obligations towards the other party, the rules on imputation of performance apply with appropriate adaptations.

COMMENTS

The party giving notice of set-off may have two or more rights against the other party, or may be exposed to two or more rights of that party, or both. Where the party giving notice has two or more rights, that party has to identify the right, or rights, to which the notice of set-off relates. If this is not done, the notice of set-off is invalid for being insufficiently specific. However, it is not necessary expressly to identify the right, or rights, to which the notice of set-off relates; the intention of the party giving notice of set-off may be inferred from the context or circumstances. If no such intention may be inferred, it must be the party giving notice of set-off who has to bear the risk of uncertainty. Set-off constitutes a form of enforcement of the cross-right and a creditor

who has several rights against a debtor must always be sufficiently specific as to which of the rights is being enforced.

Illustration 1

A has three rights for €30 each against B. B has a right for €300 against A. All rights are enforceable. A gives notice of set-off. A has to identify the right to which the notice of set-off relates. If this is not done, the notice of set-off is invalid.

Where the party giving notice of set-off is exposed to two or more rights of the other party, the party giving notice is in the position of a debtor making a payment which could be imputed to one or more obligations. Since giving notice of set-off is a means of discharging an obligation, the rules on imputation of performances should apply with appropriate modifications. This means that the determination by the party declaring set-off is normally decisive. If that party fails to determine to which of the obligations the notice of set-off relates, the other party may make the determination. Failing determination by either party, the normal default rules come into operation. In a number of national legal systems, the party receiving the notice of set-off is given the right to object, without undue delay, to the determination made by the party giving notice of set-off, provided the objecting party is in a position to give notice of set-off. This rule is based on the consideration that the issue of imputation, in the context of set-off, should not depend on which of the parties happens to give notice of set-off first. The provision in the present Article, on the other hand, is based on the desire to encourage set-off.

Illustration 2

The situation is the same as in Illustration 1, but B gives notice of set-off. B may determine which of A's three rights is discharged. If B fails to make such determination, A may within a reasonable time make such determination and inform B of the choice. Failing that, the criteria provided in III.–2:110 (Imputation of performance) paragraph (4) apply in the sequence indicated in that Article.

III.–6:107: Effect of set-off

Set-off extinguishes the obligations, as far as they are coextensive, as from the time of notice.

COMMENTS

A. No retrospective effect

Set-off does not operate retrospectively. It merely has prospective effect: it is effective as from the moment when all substantive requirements for set-off have been met and when the notice of set-off has become effective. Generally speaking, therefore, the situation has to be evaluated as if both obligations had been performed at the moment when set-off was declared. This has the following consequences.

B. Interest

Interest (on both obligations) runs until set-off has been declared. It may therefore be advantageous to the party paying the higher rate of interest to declare set-off on becoming aware of this possibility.

C. Delay in Payment

Concerning delay in payment, the position is as follows. If B under a contract of sale has to pay A a sum of €100,000 on 10 October and fails to pay on that date, B would normally have failed to perform without excuse. A has the option of claiming performance, of claiming damages or, if the non-performance is regarded as fundamental in the circumstances, of terminating for fundamental non-performance. If B fails to declare a set-off or only subsequently becomes aware of the fact that there is a right against A for the same amount, this does not condone B's breach on 10 October.

D. Agreed payment for non-performance

Whether an agreed payment for non-performance has become due from a party who has not exercised the right to give notice of set-off, depends on the interpretation of the relevant clause. Normally, the agreed sum will have to be paid.

Illustration 1

A has to pay back a sum of €10,000, which he had borrowed from B, by 10 October. The parties have agreed that A has to pay an extra amount of €2000 if he fails to return the money by that date. On 1 September A inherits from his aunt C a right of €30,000 against B. He only realises that on 20 December and declares set-off. Since A has failed to make payment on 10 October, B may right the agreed sum of €2000.

E. Payment made after set-off

If payment is made after set-off has been declared it may be reclaimed under the rules on unjustified enrichment since it is payment of what is not due (i.e. there has been a performance without legal ground). If it was made before the declaration of set-off, it has had the effect of extinguishing the obligation and thereby removing the mutuality requirement for set-off. Thus, there is no particular problem about restitution.

F. Prescription of cross-right

On the effect of prescription on the right to declare set-off, see III.-7:503 (Effect on set-off).

G. Extinction only as far as the obligations are coextensive

Set-off extinguishes the obligations only as far as they are coextensive. This means, as far as monetary obligations are concerned, that they are extinguished only to the extent of the smaller one.

Illustration 2

A has a right of €10,000 against B, B has a right of €5000 against A. Notice of set-off by either A or B leads to the result that A's obligation is extinguished entirely, whereas B still owes A €5000.

H. Set-off of part of the cross right

The party declaring set-off may set off only part of the right against the other party. The obligation corresponding to the remaining part of the right will then not be extinguished.

III.-6:108: Exclusion of right of set-off

Set-off cannot be effected:

(a) where it is excluded by agreement;

(b) against a right to the extent that that right is not capable of attachment; and

(c) against a right arising from an intentional wrongful act.

COMMENTS

A. Exclusion by agreement

Following the general principle of freedom of contract, the right of set-off may be excluded by agreement, subject to the normal limitations on private autonomy (e.g. the rules dealing with unfair standard terms). It is a question of interpretation whether an agreement to exclude set-off refers only to rights arising from a specific legal relationship or to all rights between the parties.

B. Right not capable of attachment

Set-off should not deprive a person of rights (such as those for maintenance or wages) which provide a minimum level of subsistence. The simplest, most appropriate and most comprehensive way of dealing with this issue is to prohibit set-off to the extent that the principal right is not capable of attachment. Whether, and to what extent, the principal right is capable of attachment is decided by the law applicable to that issue.

C. Right arising from an intentional wrongful act

A creditor who is unable to collect what is due may be tempted to resort to self-help. The usual textbook example of a disappointed creditor feeling free to assault the debtor (secure in the knowledge that he will be able to set off his unpaid right against the debtor's right for damages) may not appear to be practically relevant. More realistic is the situation where the creditor holds some object belonging to the debtor and proceeds wrongfully to sell that object in order to satisfy the debt out of the proceeds. In those legal systems which do not allow the attachment of rights arising from delict, subparagraph (b) of the Article would already have the effect of excluding set-off.

D. Liability for unpaid calls

In some national legal systems it is regarded as desirable to prohibit contributories to a company from setting off the company's debt to them against their liability for unpaid calls. Such a rule serves to safeguard the interest of the company's creditors in the undiminished capital fund of the company but belongs in company law rather than in the general rules on set-off.

Section 2: Merger of debts

III.-6:201: Extinction of obligations by merger

(1) An obligation is extinguished if the same person becomes debtor and creditor in the same capacity.

(2) Paragraph (1) does not, however, apply if the effect would be to deprive a third person of a right.

COMMENTS

Paragraph (1) contains a widely recognised rule of evident utility. If the same person becomes debtor and creditor in the same capacity the relevant obligation is extinguished. Paragraph (2) provides an exception to this rule where the effect of extinction by merger would be to deprive a third person of a right.

CHAPTER 7: PRESCRIPTION

Section 1: General provision

III.-7:101: Rights subject to prescription

A right to performance of an obligation is subject to prescription by the expiry of a period of time in accordance with the rules in this Chapter.

COMMENTS

A. Terminology and meaning of prescription

In traditional civilian terminology the term "prescription" comprehends (i) the acquisition of title to property as a result of the lapse of time ("acquisitive prescription") and (ii) the loss of a right as a result of the lapse of time ("extinctive prescription"). Predominantly, however, the combination of both types of prescription under one doctrinal umbrella is no

longer regarded as helpful since they are largely governed by different rules. This Chapter deals only with the latter type of prescription. The term "extinctive" prescription, however, is incorrect in the present context because, under the rules set out in this Chapter, the right is not extinguished. It continues to exist but the debtor is granted a right to refuse performance; see III.–7:501 (General effect) paragraph (1). More appropriate, though not very descriptive, is the terminology of Scottish law ("negative prescription"). An alternative would be "liberative prescription". Another possibility would be "limitation of rights", i.e., a transposition into terms of substantive law of the English concept of "limitation of actions". For the sake of simplicity and since these rules do not deal with acquisitive prescription the term "prescription" is generally used without any qualifying adjective.

In the Articles the term "prescription" refers to the legal effect on the right of the lapse of time. Prescription occurs at a precise moment. The term "period of prescription" refers to the period on the expiry of which prescription occurs.

B. Prescription of rights to performance

Central to the institution of prescription is the notion of a right to performance of an obligation. Prescription is thus conceived as an institution of substantive law: because of the lapse of time the debtor is entitled to refuse performance. If the debtor does so, the creditor effectively loses the right to demand performance. As a result, of course, the creditor can no longer pursue the right in court. But prescription does not only limit the right to bring an action: it bars the actual right to receive performance. Thus, for instance, where a debtor invokes prescription against a demand to pay, and where all requirements for prescription are met, the debtor is no longer delaying payment and therefore no longer suffers the consequences attaching to non-performance of an obligation.

Since prescription applies only to rights to performance of an obligation, it does not affect a party's right to give notice of avoidance, to terminate for fundamental non-performance, or to affect a legal relationship in any other way. The specific rules governing such rights generally require them to be exercised within a reasonable time. (On such special time limits, see also D, below.)

C. Right to withhold performance and right to reduce the price

The right to withhold performance is also not subject to prescription. This means that the right to withhold performance is still available even if the prescription period for the right on which it is based has run out.

Illustration

A has sold a car to B. The car has to be delivered on 10 October 1996, the purchase price has to be paid on 10 December of the same year. The prescription period for both rights is three years. After three years, B has still not received the car. If B sues A for the car after 10 October, A can raise the defence of prescription. If A, in turn, sues B for the purchase price on 10 November, B may exercise the right to withhold performance; it remains unaffected by the

prescription of B's own right against A. After 10 December, B can raise the defence of prescription against A's claim.

The right to reduce the price is also not subject to prescription. If a party, as a result of having accepted a performance not conforming to a contract, has such a right of reduction, it may be exercised when the other party demands payment. The right to payment itself, of course, is subject to the normal rules of prescription. If the party entitled to reduce the price has already paid a sum exceeding the reduced price, the excess may be recovered from the other party. This right to payment of the overpaid amount is subject to the normal rules of prescription.

D. Range of application

This Chapter applies not only to contractual rights but also to other rights to performance. It would be unjustifiable in theory, and productive of difficulty and inconvenience in practice (see the Comments to III.–7:201 (General period)) to apply the rules on prescription only to some rights to performance. On the other hand, it does not appear to be advisable to cover other types of asset or right, such as property rights or the right to marry or the right to be an heir or executor. Here we are often dealing with the protection of absolute rights (such as the right of ownership). If they were subject to prescription, this would entail a considerable, and arguably unjustifiable, qualification of the absolute right. Thus, it may be maintained that rights arising from absolute rights should only perish with the absolute right itself. Also, within the law of property there will have to be a careful co-ordination with the law of acquisitive prescription, or usucaption. At the same time, the law on rights to performance of obligations is a sufficiently broad and distinct area of the law to warrant a special set of rules. The comparative evidence points in the same direction: most modern prescription regimes apply, expressly or at least effectively, to the law of obligations.

These rules contain a number of time limits (e.g. for acceptance; for a notice of avoidance; for a notice of termination for non-performance; and for the right to seek specific performance). These time limits do not constitute prescription periods. However, some of the rules contained in this Chapter (e.g. III.–7:303 (Suspension in case of impediment beyond creditor's control)) express policies which are also relevant in assessing whether an acceptance has been declared, or a notice of avoidance or of termination has been given, or specific performance has been sought, within a reasonable time from the moment set out in the relevant provisions.

The rules contained in this Chapter do not rule out the possibility that a party may be barred from pursuing a right even before the period of prescription has run out. This may be the case if the party has engendered reasonable reliance in the other party that the right would no longer be pursued and if the decision to pursue the right would therefore constitute a breach of the principle of good faith and fair dealing.

E. Underlying policy considerations

Prescription is based, essentially, on three policy considerations. (1) Protection must be granted to a debtor who, in view of the “obfuscating power of time” (Windscheid & Kipp § 105 (p. 544)), finds it increasingly difficult to defend an action. (2) Lapse of time demonstrates an indifference of the creditor towards the right which, in turn, may engender a reasonable reliance in the debtor that no claim will be pursued. (3) Prescription prevents long drawn-out litigation about claims which have become stale. Thus, prescription aims, in a very special way, at legal certainty. Even well-founded claims may be defeated, but that is the necessary price a legal system has to pay for the benefits of prescription. The need for legal certainty must, however, be balanced against the reasonable interests of the creditor. Since prescription can effectively amount to an act of expropriation, the creditor must have had a fair chance of pursuing the claim. This consideration is taken account of, particularly, by the suspension ground provided in III.–7:301 (Suspension in case of ignorance)

In spite of its potential for causing harsh results in individual cases, prescription is generally regarded as an indispensable feature of a modern legal system.

Section 2: Periods of prescription and their commencement

III.–7:201: General period

The general period of prescription is three years.

COMMENTS

A prescription regime has to be as simple, straightforward and uniform as possible. This is why the Chapter lay down a general period of prescription covering all rights to performance of an obligation.

A. The argument for uniformity

One of the functions of the law of prescription is to prevent costly and long-drawn out law-suits (*ut sit finis litium*). It would therefore be intolerable if the prescription rules themselves gave rise to excessive litigation on the question whether or not prescription had occurred in a particular case. Wherever a rule lays down a period of prescription for a specific type of right, it is necessary to define that type of right. The concepts used in any such definition, however, are open to interpretation. At the same time, any type of right described in one provision will be bordering on other rules providing for different periods of prescription. Every creditor against whom the shorter of the two periods has run out will thus be tempted to argue that the right falls under the provision with the longer period, and the courts will then have to determine where exactly the line between the two provisions must be drawn. If one of the prescription rules is regarded as objectionable,

there is the added danger that courts and legal writers may be tempted to distort the concepts used in these rules and to redefine the borderline between, for instance, different types of contract from the point of view of prescription rather than from a general perspective.

Moreover, there do not appear to be any general criteria which would be both sufficiently clear and convincing to provide a basis for a differentiated prescription regime, at least not within the law of obligations. Thus, one might want to subject rights arising from everyday transactions, or of a petty nature, to shorter periods of prescription than complex or extraordinary rights. But it is impossible to draw a plausible borderline and to define this borderline in precise statutory terms. Another potential point of reference might be the professional position of the creditor or debtor. But any regulation based on it would either be very casuistic and in permanent danger of being outdated, or too abstract and general (and thus open to conflicting interpretation). Moreover, any such differentiation would only appear to make sense as far as the right to performance under a contract and possibly also a right to damages for breach of contract are concerned. It is much less convincing for other rights arising *ex lege*, with the handling of which even a professional person often has little experience.

The most common criterion employed in the context of differentiated periods of prescription is the (legal) nature of the right. But this criterion, too, does not ultimately appear to be suitable. Whether or not prescription has occurred is a question which often has to be determined at a time when the legal position between the parties is unclear. It may be doubtful whether a contract is valid. The creditor does not, therefore, know whether there is a right to specific performance, to damages, or to redress of unjustified enrichment. Or a contract may lie on the borderline between sale and lease, or sale and the contract for work, or the contract for work and the contract of service. Or the creditor's right to damages may be based on contract or on the fact that damage has been caused by another in a non-contractual situation or on *culpa in contrahendo*, wherever that may fit in. Hardly any right within the law of obligations can be dealt with in isolation. This interconnectedness is of particular relevance with regard to the law of prescription – with the result, *inter alia*, that differentiated periods of prescription tend to lead to inconsistencies in result and evaluation.

Thus, for instance, rights to reversal of an unjustified enrichment arising as a result of the invalidity of a contract should not prescribe within a longer period than contractual rights to specific performance: the "obfuscating power of time" hits the debtor as hard in the one case as in the other. At the same time, it would be inadvisable to differentiate between contractual restitution rights and those based on unjustified enrichment, or between the different types of unjustified enrichment rights. Unjustified enrichment, moreover, is frequently an alternative to benevolent intervention (*negotiorum gestio*). Also, there is so often a concurrence between rights based on unjustified enrichment and rights based on damage caused by another in a non-contractual situation that they should be subject to the same prescription regime. Rights of the latter type are so closely related to *culpa in contrahendo* (fault in the process of contracting) or to contractual rights for

consequential loss that no distinction should be drawn here either; and rights to damages for non-performance should not, at any rate, be subject to a longer period of prescription than the right to specific performance in view of the aggravated problems of proof. In this way nearly all important types of right are interconnected with each other. This is also the reason why the prescription rules should not be tailored specifically to contractual rights. If prescription rules are to conform to the general policy objectives mentioned in the Comments to III.– 7:101 (Rights subject to prescription), they cannot attempt to provide the best possible regime for each individual type of right but must be applicable as broadly as possible. In particular, they have to take account of the need for clarity, certainty and predictability which is jeopardised by any unnecessary complexity. Thus, on balance, it is better to have a regime that does not suit all rights equally well than one that makes it difficult for debtors as well as creditors to assess their position and adjust their behaviour accordingly.

It is also not advisable to lay down (as some codifications do) a special rule for rights to periodical performances. The range of such rights is difficult to define. Moreover, the need for a special rule has to be evaluated against the background of a very long general period of prescription (e.g. thirty years). In the Chapter, however, the general period is only three years.

The general period laid down in the Chapter covers all rights to performance of obligations. It has been pointed out above that any differentiation within this area of the law may easily lead to inconsistency and distortion. Rights of a different nature arising in other areas of the law (especially property law, family law and succession) are not covered by this Chapter.

B. International trends

If we look at the development of the law of prescription, at new enactments and drafts proposed, over the past hundred years we find (i) a trend towards shorter periods of prescription and (ii) a trend towards uniform periods of prescription. And while modern European legal systems still recognise a large variety of periods, ranging from six months to thirty years, more and more rights in more and more countries are subject to a prescription period of between two and six years; and there is a growing conviction that the general period should be somewhere between these poles. To a certain extent the choice is arbitrary. But if a third international trend is also kept in mind, namely the increasing recognition of the discoverability criterion (see III.–7:301 (Suspension in case of ignorance)), a period closer to the lower rather than the upper end of this spectrum should be chosen. For as long as a legal system makes sure that the period of prescription does not run against a creditor who does not know, and cannot reasonably know, of the claim, it may expect the creditor to act reasonably expeditiously. Three years is the period provided in an important act of European legislation - the Product Liability Directive (85/374/EWG) art. 10 - and it appears to be more and more accepted as a general standard within EU legislation.

III.-7:202: Period for a right established by legal proceedings

(1) The period of prescription for a right established by judgment is ten years.

(2) The same applies to a right established by an arbitral award or other instrument which is enforceable as if it were a judgment.

COMMENTS

A. The need for a special period

This is the only special prescription period provided in this Chapter. It cuts off any potential doctrinal discussion as to the effect of the judgment on the original right. (Does it continue to exist, or is it replaced by a new right?) The period applicable in this case has to be substantially longer than the general period laid down in III.-7:201 (General period). A right established by judgment is as firmly and securely established as is possible and is thus much less affected by the "obfuscating power of time" than other rights. Moreover, the creditor has made it abundantly clear that the right is seriously pursued; the debtor knows that payment is still required. And finally, the legal dispute between the parties has been resolved. It does not create a source of uncertainty or a danger to the public interest. To the contrary: it would create unnecessary costs, and thus be more injurious to the public interest, if a short prescription period were to force the creditor at regular intervals to attempt an act of execution which, in view of the debtor's financial position, is known to be futile. The law of prescription here, as always, should prevent, not encourage or even engender, litigation.

Once again, of course, there is something arbitrary in fixing a specific period. But ten years would appear to be a reasonable choice in view of the fact that it is the period most frequently found, or proposed, in modern legislation.

Admittedly, the introduction of a special period for rights established by judgment is in conflict with the general quest for uniformity. But we are dealing here with a clearly distinguishable type of right which does not interfere with any others covered by this Chapter. The general reasons militating against a differentiated regime do not apply in this case.

B. Nature of the period; declaratory judgments

The ten year period proposed is a normal prescription period which is subject to the general rules. The one issue that merits special consideration is when it starts to run: see the provision in III.-7:203 (Commencement); cf. also the provisions on renewal of prescription in III.-7:401 (Renewal by acknowledgement) and III.-7:402 ((Renewal by attempted execution).

A declaratory judgment is sufficient for the purposes of the present Article, as long as it establishes the right and not only one of its prerequisites.

C. Other instruments

It cannot be specified in this Chapter which other instruments obtained by the creditor can have the effect of triggering the ten year period. The relevant criterion is whether they are regarded as enforceable as if they were a judgment. A court-approved settlement of the dispute between the parties could be one example. Private instruments are also covered as long as they do not require a formal act by a court before they can be enforced but may be enforced directly. Arbitral awards are mentioned because of their general recognition and practical importance.

III.–7:203: Commencement

(1) The general period of prescription begins to run from the time when the debtor has to effect performance or, in the case of a right to damages, from the time of the act which gives rise to the right.

(2) Where the debtor is under a continuing obligation to do or refrain from doing something, the general period of prescription begins to run with each breach of the obligation.

(3) The period of prescription set out in III.–7:202 (Period for a right established by legal proceedings) begins to run from the time when the judgment or arbitral award obtains the effect of res judicata, or the other instrument becomes enforceable, though not before the debtor has to effect performance.

COMMENTS

A. General rule

As a rule, the period of prescription should run only against a creditor who has the possibility of enforcing the right in court, or of starting arbitration proceedings. For it is in the course of these proceedings that the merits of the case will be investigated. The running of the period is suspended as long as the proceedings last (see III.–7:302 (Suspension in case of judicial and other proceedings)). A right can, however, only be pursued in court, or before an arbitration tribunal, when it has become due - that is, when the debtor has to effect performance. The concept of the time when a party has to effect performance is widely known and relevant in many other situations.

Illustration 1

A and B have agreed that A has to pay the purchase price for a car delivered to B on 10 October. The time for A's performance is determinable from the contract: it is 10 October. The period of prescription starts to run against B on that day.

Illustration 2

A has, by mistake, transferred a sum of money to C rather than to B. From the moment when he receives the transfer, C is under an obligation to retransfer the

money; this obligation is based on unjustified enrichment. The period of prescription relating to A's right to the retransfer starts to run on that day.

B. Rights to damages

There is, however, one situation which requires special consideration. A right to payment of damages for harm caused by another is generally due as soon as the right comes into being. But it comes into being only when all requirements of the rule imposing liability have been met. One of them will often be the occurrence of damage; and damage will sometimes only occur many years after the act giving rise to liability (for example, infringement of somebody else's bodily integrity, or rights to property) has been committed. Thus, it may be uncertain for a number of years whether a person has a right to damages based on an act infringing their rights. Moreover, it may be difficult to determine whether all rights to damages arising as a consequence of the act have to be subjected to the same prescription regime, or whether there may be completely unexpected, latent consequences in relation to which prescription should only start to run once they have become apparent. Pure economic loss cases also present special problems in the application of a rule that focuses on the occurrence of damage. Thus, it appears advisable not to make commencement of the period of prescription dependent upon the occurrence of damage. The period of prescription, therefore, begins to run when all the other requirements for the right to damages have been met, i.e. at the moment when the relevant act has been committed (or at the moment when the non-performance of an obligation has occurred). This rule does not cause hardship to the claimant, since the period does not run, according to III.-7:301 (Suspension in case of ignorance), as long as the claimant does not know, and cannot reasonably know, about any latent damage. Thus, it is practically relevant only for the calculation of what is usually described as the "long-stop", and what is in this Chapter expressed as the maximum period to which the period of prescription can be extended (III.-7:307 (Maximum length of period)). Here, however, an easily ascertainable date is required to counterbalance the uncertainty necessarily associated with the discoverability criterion. This date can only be the commission of the act which gives rise to the right to damages. The specific advantage of the rule proposed here is that it provides, effectively, one and the same point of departure for the general prescription period and the "long-stop".

Illustration 3

A has been injured, on 1 October 1976, in a car accident for which B has been responsible. A appears to have suffered only light injuries (a bruise, or a mild concussion). In the summer of 1981, however, it turns out that an inner organ has been seriously affected. The three year prescription period would begin to run from 1 October 1976 but for the fact that it is suspended as long as A did not know, and could not reasonably know, about the latent consequences of the accident, i.e., in this case, presumably sometime in the summer of 1981 (III.-7:301). If the latent consequences should have become apparent only in December 2006, A's right would have been prescribed in view of the fact that the period of prescription cannot be extended beyond a total period of thirty years (III.-7:307 (Maximum length of period)).

The same considerations apply to other rights to damages. The period of prescription of a right to damages for non-performance of an obligation runs from the date of non-performance, the period of prescription of a right to damages for *culpa in contrahendo* from the moment when the other party breaks off negotiations contrary to good faith and fair dealing.

C. Obligation to refrain from doing something

Prescription relates to rights to performance of obligations (III.–7:101 (Rights subject to prescription)). This covers cases where a party is under an obligation to refrain from doing something. When does the period of prescription begin to run in these cases? The due date cannot be the appropriate moment since the creditor's right is due even before the debtor has infringed the obligation. Yet, before such infringement has occurred, the creditor does not normally have any reason to sue the debtor so as to stop the period of prescription from running. Prescription problems can only arise where the debtor's obligation extends over some period of time, i.e. in the case of a continuing obligation to refrain from doing something. Here it appears to be appropriate for the period of prescription to commence, not once and for all with the first act of contravention, but with each new act of contravention.

Illustration 4

A has a studio in which he occasionally produces CD's of famous pianists. On 10 October, he plans to produce a CD with Alfred Brendel playing Schubert. B, A's neighbour, is busy with noisy building operations to his house in the course of the month of October. A obtains an undertaking from B to stop these building operations for 10 October. Nevertheless, B carries on with them on that day. Here we do not have specific prescription problems. Before 10 October, a period of prescription cannot start; after 10 October, compliance has become impossible and A can only claim damages. The right to damages is subject to the normal rules of prescription.

Illustration 5

A is a former employee of B, an insurance company in Hamburg. She is under an obligation not to sell any insurance policies on her own account for the next three years in Hamburg. On 20 March, she sells some policies in a small suburb still belonging to the state of Hamburg. On 20 October, however, she sets up her own insurance agency right in the centre of Hamburg. Concerning the infringement on 20 March, the period of prescription begins to run on that day; concerning the one on 20 October, a new period begins to run on 20 October. This is justified in view of the fact that B may have refrained from taking steps which would have had the effect of extending or even recommencing the period of prescription, not because it wanted to condone any infringement of A's obligation, but merely because the first infringement was not sufficiently serious to warrant the cost and trouble of taking such steps.

The same problem may arise where the debtor is under a continuing obligation to do something.

Illustration 6

D, the owner of a dairy, has agreed to deliver 20 cans of milk to a restaurant in the neighbourhood every morning. As long as D complies with this obligation, the owner of the restaurant has no reason to sue him. He may, quite legitimately, not even want to sue him when occasionally less than the 20 cans are delivered or when, due to momentary difficulties that D may have with his own suppliers, he does not deliver at all for a day or two. That should not, however, prevent him from bringing an action against D if the latter, four years later, decides no longer to honour his obligation.

D. Rights established by legal proceedings

Here the choice would seem to be between the date of judgment and the date when that judgment becomes final (i.e. when an appeal is not, or no longer, possible). The second of these alternatives is the one more often found in existing legislation. It commends itself for reasons which will become apparent when the closely related question of the effect of legal proceedings upon a period of prescription is considered (see III.-7:302 (Suspension in case of judicial and other proceedings)). In order to cover all types of appeal that may possibly be brought against a judgment, paragraph (2) refers to the moment when the effect of *res judicata* is obtained.

If a declaratory judgment establishes an obligation on the part of the debtor to make periodic payments in the future, the period of prescription concerning each of these payments only starts to run when it falls due (see the clause starting with the words "though not" in paragraph (2)).

In the case of arbitral awards the relevant moment may also be described as the moment when the effect of *res judicata* is obtained. For other instruments, however, the period of prescription begins to run when they become enforceable (III.-7:203 ((Commencement) paragraph (3); enforceability, after all, is the characteristic that justifies placing these instruments on a par with a judgment (III.-7:202 (Period for a right established by legal proceedings) paragraph (2)).

Section 3: Extension of period

III.-7:301: Suspension in case of ignorance

The running of the period of prescription is suspended as long as the creditor does not know of, and could not reasonably be expected to know of:

(a) the identity of the debtor; or

(b) the facts giving rise to the right including, in the case of a right to damages, the type of damage.

COMMENTS

A. Terminology

Civilian legal systems traditionally distinguish between "interruption" and "suspension" of a period of prescription. If the period of prescription is interrupted, the time which has elapsed before the interrupting event is not taken into account: the period of prescription begins to run afresh. Suspension of the period of prescription, on the other hand, has the effect that the period during which prescription is suspended is not counted in calculating the period of prescription: when the cause of suspension ends, it is therefore the old prescription period that continues to run its course (unless the period of prescription had not even started to run in which case it only starts to run after the cause of suspension has ended). Suspension thus extends a given period of prescription. Another device that has the effect of extending the period of prescription is postponement of its expiry. Here the period of prescription runs its course but is only completed after the expiry of a certain extra period. The Chapter uses these three techniques but does not use the word "interruption", which can be misleading. Instead the Chapter uses the term "renewal" to cover the case where a new period begins to run on the happening of some event. Thus, the systematic exposition for Sections 3 and 4 is as follows. The period of prescription can be (i) extended (Section 3) or (ii) renewed, so that a new period begins to run (Section 4). An extension may occur by way of (a) a suspension of the running of the period or (b) a postponement of its expiry. It should be noted that the running of a period of prescription can be suspended whether or not it has already started. A renewal may be triggered by an acknowledgement by the debtor or, in the case of the ten year period, by an attempt at execution by the creditor.

B. The argument for a general discoverability criterion

Prescription can effectively amount to an act of expropriation: a right is an asset of the creditor which loses its value if it can no longer be pursued in court. This is justifiable only if the creditor has previously had a fair chance of pursuing the claim. So, in the first place, the creditor must have known about the right or, at least, ought reasonably to have known about it. The importance of a discoverability criterion is accentuated, if (as under the Chapter) the general prescription period is comparatively short. Whereas the short period, and the institution of prescription of rights as such, are largely intended to protect the debtor, the discoverability criterion provides the necessary counterbalance to take account of the creditor's reasonable interests. This is increasingly recognised today. Not surprisingly, the rise of the discoverability criterion has been closely related to the general tendency towards shorter prescription periods. More precisely, there has been a trend towards (i) taking account of the creditor's ignorance with regard to a growing range of rights while (ii) reducing the inherent potential of this consideration for delaying the course of prescription by moving from lack of knowledge towards a test of reasonable discoverability. The Chapter reflect these developments.

Essentially, there is a fundamental choice to be made. If discoverability applies across the board, a uniform three year period is acceptable. If, however, the uncertainty necessarily

associated with a discoverability criterion is regarded as sufficiently serious to make the running of prescription dependent merely on objective criteria, the consequence is necessarily a differentiated system of prescription periods. But there is a very wide consensus that not all types of rights can be subjected to an objective regime: the prescription of non-contractual rights to compensation for damage caused by another must depend on knowledge (or reasonable possibility to acquire knowledge). It is, however, precisely with regard to such rights (and, more specifically, those arising from personal injury) that the discoverability criterion is particularly important. The other type of situation where a creditor will often be unaware of the right is non-performance of a contractual obligation. Non-contractual rights for damages and rights for damages based on non-performance of a contractual obligation can be closely related; the one right is often an alternative for the other. If it is unfair in the one case for the right to prescribe before the creditor knew or reasonably could have known of it, it is equally unfair in the other. Once, however, a legal system is prepared to swallow the subjective criterion with regard to rights to damages it might as well, given the interconnectedness of rights within the law of obligations, accept it across the board. The price to be paid in terms of legal uncertainty is not considerable. For, to mention some prominent types of rights, the parties to a contract will normally know when their contract has been concluded and when they are entitled to demand (specific) performance of the obligations arising under it. Also, they will usually be aware whether the contract has been avoided with the result that they may claim a reversal of any enrichment conferred, particularly under a system that makes avoidance for error, or fear, or fraud dependent on notice to the other party. And certain rights to reversal of unjustified enrichment based on unauthorised use of a person's assets are too close to non-contractual rights to compensation for damage caused by another to justify a different treatment.

C. What must be discoverable?

What, precisely, must the creditor's lack of knowledge relate to? It seems to be widely agreed that the facts giving rise to the right and the identity of the debtor are the two key issues.

Illustration 1

In the course of the early morning of 10 October 1994, A crashes his car into B's car which was parked in front of B's house. Since A fears public prosecution for drunken driving, he drives away from the scene of the accident. Nobody has observed the accident. Early in 1998, and in the course of a pub crawl, A boasts about what has happened that night. One of the persons present relates the story to B who now wants to sue A for damages. The running of the period of prescription (which would normally have begun on 10 October 1994) was suspended until B had heard about A's involvement in the accident. Before that time, he did not know and could not reasonably have known about the identity of his debtor.

In addition, a significance test is sometimes recommended: the running of the period of prescription is also suspended as long as the claimant did not know, and could not reasonably know, that the right is significant. This test is designed to prevent an apparently trivial injury triggering the prescription period for unexpected, serious

consequences arising from the injury at a later stage. These concerns are also reflected in the development of the case law of a number of countries. Another, related, problem arises in cases where the victim of an accident is aware, at first, of having suffered, for instance, damage to property and only later becomes aware of an injury to health as a result of the accident. Both types of cases are covered by the words "type of damage" in clause (b).

Illustration 2

On his way home from a football match one November, A is beaten up by supporters of another team. He has a laceration on his forehead which, at first, bleeds heavily but can quite easily be dressed. He therefore decides not to take action against those who have beaten him up. Only eleven months later, in the following October, does he become aware of the fact that he has picked up internal injuries of a much more serious nature. The period of prescription starts to run from that time in October.

Illustration 3

A is severely injured in a brawl in the course of which B has hit his head with a club. As a result of this, A's eyesight is diminished by 40 %. Four years later, A becomes completely blind. It can be established that this is a late result of B hitting A's head. Running of the period of prescription for the damage resulting from blindness (as opposed to the loss of 40 % of his eyesight) is suspended until A has become blind (unless that consequence was reasonably foreseeable at the date of the injury).

D. Ignorance as a ground for suspending the running of the period of prescription

The period of prescription should not run while the creditor is unaware of the right and cannot reasonably be expected to be aware of it. It might appear natural to link the discoverability criterion to the commencement of the period of prescription. This is not the approach adopted here. The starting date remains the moment when the debtor has to effect performance, but the running of the period of prescription is suspended until the creditor becomes aware of the right or could reasonably be expected to be aware of it. This means that normally the period of prescription does not start to run until the moment of reasonable discoverability; it is, in other words, a case of an "initial" suspension. Matters are different, where the creditor's ignorance is not an initial one; this may be the case when either the creditor or the debtor dies and either the new creditor does not know that the right has been inherited or the old creditor cannot reasonably find out who is the new debtor.

Ignorance as a ground of suspension of the running of the period of prescription (as opposed to knowledge as the criterion for commencement of the period) has the following advantages. (i) Even if discoverability were to determine commencement of the period of prescription, it would also have to be required that the obligation has come into existence and that performance is due. (ii) That the period of prescription should not run

against a creditor who cannot reasonably be expected to be aware of the right is one specific emanation of a much wider idea: a right must not prescribe if it is impossible for the creditor to pursue it (*agere non valenti non currit praescriptio*). This is why the period of prescription does not run in cases of *vis major* and why the expiry of the period of prescription is postponed if the creditor is legally incompetent and does not have a legal representative. These (and other) impediments are taken into account by extending the period of prescription. It does not matter whether the impediment already existed at the time of commencement of the period of prescription. Thus, it would appear to be systematically more satisfactory to deal with the discoverability issue under the same heading. (iii) A creditor who brings an action against the debtor has to establish the requirements on which the right is based. That the right has not prescribed is not one of these requirements. Prescription is a defence. If it is invoked by the debtor, it is the debtor who has to establish the requirements of that defence. The central requirement, of course, is that the period of prescription applicable to the right has elapsed. That depends on the date of commencement. If that were the date of discoverability, the debtor would, in many cases, face an unreasonably difficult task. For whether the damage to the creditor's house, the injury to the creditor's body, the consequences flowing from defective delivery, etc. were reasonably discoverable, or whether the creditor perhaps even had positive knowledge, are matters within the creditor's sphere and largely removed from the debtor's range of perception. Also, by and large, and considering the full range of rights, the creditor will normally know about the right at the time it falls due. That, exceptionally, this was not so, is a matter to be raised, and established to the satisfaction of the court, by the creditor. This would come out more clearly if discoverability were not to be made a requirement for commencement of the period of prescription but if the fact that the creditor could not reasonably be expected to be aware of the right were to give rise to an extension of the period of prescription: for it would, according to general principle, normally be for the creditor to prove that the running of the period of prescription was suspended, or that the period was otherwise extended. (iv) This way of proceeding also considerably simplifies the structure of the prescription regime, for it dispenses with the need to lay down a separate "long-stop" period running from a date different to that for the "normal" period of prescription and subject to specific regulation concerning extension, renewal, etc. It merely has to be stated that the period of prescription cannot be extended to a period longer than ten (or thirty) years (see III.-7:307 (Maximum length of period)).

III.-7:302: Suspension in case of judicial and other proceedings

(1) The running of the period of prescription is suspended from the time when judicial proceedings to assert the right are begun.

(2) Suspension lasts until a decision has been made which has the effect of res judicata, or until the case has been otherwise disposed of. Where the proceedings end within the last six months of the prescription period without a decision on the merits, the period of prescription does not expire before six months have passed after the time when the proceedings ended.

(3) These provisions apply, with appropriate adaptations, to arbitration proceedings and to all other proceedings initiated with the aim of obtaining an instrument which is enforceable as if it were a judgment.

COMMENTS

A. The options

A creditor who institutes an action to assert the right does what the law of prescription expects: the creditor takes the initiative to bring about an authoritative resolution of the dispute. It would be manifestly unfair if the period of prescription were to continue to run while judicial proceedings are pending. The debtor is now able to raise whatever other defence there may be and knows that the creditor is not treating the incident as closed. The proceedings prevent the right from becoming stale.

In this situation a legal system can do one of three things. It can determine (1) that the period of prescription ceases to run; or (2) that it is "interrupted" or renewed, with the effect that it starts to run afresh or (3) that its running is suspended as long as legal proceedings are pending.

Cessation of period of prescription. The first option (cessation) is the one following most naturally from a concept of a limitation of actions. It does not commend itself for rules of private law for it either leaves open the question of what happens when the legal proceedings have ended without a decision on the merits of the case, or it has to deal with this situation by way of a somewhat artificial fiction.

Interruption or renewal of period of prescription. The second option (interruption or renewal) is the solution traditionally adopted in Roman-law based legal systems. There is, however, something odd in the idea that the bringing of an action should renew rather than merely suspend the period of prescription. For by instituting an action the creditor sets in motion the court proceedings which last until a decision is given or until the case has been otherwise disposed of. Thus, we are not, as in other cases of renewal, dealing with a momentary event which could not sensibly extend the original prescription period, but with a continuing process. At the end of this process, there is normally clarity about the merits of the claim. And if there is not, there is no reason to have the entire period of prescription run afresh. Those legal systems subscribing to the interruption approach normally either specify how long the "interruption" lasts, or regard every act by any of the parties to the proceedings, and by the court, as a new cause of interruption. Both solutions are unsatisfactory. In particular, they lead to unnecessary complexities as well as undesirable practical consequences in cases where the proceedings have ended without a decision on the merits of the claim. Even an action that is dismissed without consideration of the merits (because it has been brought before a court lacking jurisdiction or because it is procedurally defective in other ways) has to have some effect on the running of the period of prescription because: (a) the creditor cannot always avoid the defect; (b) it would be impracticable to investigate in every individual case whether

the creditor can be blamed for proceeding; and (c) the creditor has, after all, demonstrated a determination to pursue the claim. Legal systems subscribing to the interruption option can only come to one of two conclusions in this situation: the period of prescription is interrupted (which would go too far); or it is not interrupted after all (which not only entails clumsy fictions but is also practically unsatisfactory for the reason just mentioned).

Suspension of running of period of prescription. The preferable solution, therefore, is the third option: the running of the period of prescription is suspended while the legal proceedings last. If these proceedings lead to a judgment on the merits of the claim, there are two possibilities. Either the claimant succeeds in which case the right is now established by legal proceedings and thus subject to the prescription period of III.–7:202 (Period for a right established by judicial proceedings). Or the action is dismissed and it is now authoritatively settled that there is no right that could be subject to prescription. Where the proceedings end without a decision on the merits (because the action is procedurally defective, or because it has subsequently been withdrawn), the creditor has what remains of the old period of prescription to bring a new action. This is exactly what is required, subject to the special situation mentioned in the following Comment. In particular, no certainty as to the substance of the right has been achieved which might justify the setting in motion of an entirely new period of prescription under headings (i) and (iii) of the policy considerations mentioned in Comment E to III.–7:101 (Rights subject to prescription).

B. Details of implementation

Special attention has to be paid to the claimant whose action is dismissed, for procedural reasons, at a time when only very little of the old period of prescription is left. Here it may be regarded as reasonable to fix a minimum period which the claimant should have for taking action after suspension has ended. This is achieved by the second sentence of paragraph (2), which gives the creditor a minimum of six months after the proceedings have ended without a decision on the merits.

When suspension begins depends on what is regarded, under the applicable law, as an appropriate act to commence a lawsuit. Suspension lasts until a decision has been passed which is final in the sense of having the effect of *res judicata*, or until the case has been otherwise disposed of. Conveniently, therefore, if the judgment has been in favour of the claimant, the period of prescription of the right based on the judgment should also only start at that moment (see III.–7:203 (Commencement) paragraph (3)) and not when judgment is given. The latter approach would appear to be related to the view, rejected above, that every event within the legal proceedings, including the judgment itself, constitutes a cause of interruption.

Illustration

A has a right against B which is due on 15 March 2004. On 1 March 2007, A commences judicial proceedings on this right before the regional court in Regensburg. On 10 October 2007, the court passes a decision dismissing the right

for lack of jurisdiction: the action should have been brought before the local court in Regensburg. On the same day, A waives the right to appeal. The running of the period of prescription was suspended between 1 March (the date when judicial proceedings were begun) and 10 October 2007 (the date when the decision of the regional court obtained the effect of *res judicata*). As a result, A now has another fourteen days to commence legal proceedings before the local court in Regensburg.

Normally, the claimant will bring an action with the aim of obtaining a title to start execution. However, an application for a declaratory judgment establishing the right is sufficient for the purposes of suspending the running of the period of prescription: just as the declaratory judgment itself is sufficient to warrant application of the special regime provided in III.–7:202 (Period for a right established by judicial proceedings).

C. Other proceedings

The rules applicable to judicial proceedings also apply to other proceedings, as long as these proceedings aim at procuring an instrument which is enforceable. Details depend on the applicable law. Arbitration proceedings are specifically mentioned because of their general recognition and practical importance. The general rule, as far as the commencement of arbitration proceedings are concerned, has to be that the creditor must have done everything in the creditor's power to start them. In the case of private instruments which may be enforced directly (see Comment C to III.–7:202 (Period for a right established by judicial proceedings)) it must be left to interpretation when the proceedings are begun.

III.–7:303: Suspension in case of impediment beyond creditor's control

(1) The running of the period of prescription is suspended as long as the creditor is prevented from pursuing proceedings to assert the right by an impediment which is beyond the creditor's control and which the creditor could not reasonably have been expected to avoid or overcome.

(2) Paragraph (1) applies only if the impediment arises, or subsists, within the last six months of the prescription period.

COMMENTS

The creditor must have a fair chance of pursuing the claim: otherwise prescription would operate unduly harshly. The creditor can hardly, however, be reproached for not pursuing a proceedings when not able to do so: *agere non valenti non currit praescriptio*. Also, it must be remembered that while the short general period of prescription set out in III.–7:201 (General period) accommodates the reasonable interests of the debtor, the rules concerning commencement and suspension of the period of prescription have to be tilted in favour of the creditor. Moreover, it would seem incongruous to protect a creditor who does not know about the right and not one who is unable to pursue proceedings to assert it. There is, however, no compelling reason to extend the period of prescription if the

impediment preventing the institution of an action has ceased to exist well before the end of the prescription period. Thus, it would appear to be quite sufficient to extend the period of prescription by the amount of time for which the creditor was prevented, within the last six months of the prescription period, from pursuing proceedings to assert the right.

Illustration 1

B has a right for €100,000 against A, which has fallen due on 10 March 2002. On 1 January 2003 B's holiday resort in Austria is cut off from the outside world by a huge avalanche. Only two weeks later are communications restored and is he able to leave the resort. Prescription of A's right occurs on 10 March 2005. The period is not extended since although A was prevented from claiming his money for two weeks in 2003 on account of an impediment beyond his control, he still had more than two years after that event to pursue his claim.

Illustration 2

The facts are as above but B is cut off between 25 August and 6 September 2004. Prescription of the right only occurs on 16 March 2005 since the impediment prevented B from exercising his right for six days within the last six months of the prescription period.

Illustration 3

The facts are as above but B is cut off between 20 and 23 January 2005. Prescription of the right occurs on 14 March 2005 since B was prevented from exercising his right for four days within the last six months of the prescription period.

Illustration 4

The facts are as above but B is cut off between 6 and 14 March 2005. Prescription of the right occurs on 18 March 2005. B was prevented from exercising his right for nine days due to an impediment arising within the last six months of the prescription period. Suspension began on 6 March and ended on 14 March. But what was suspended was the running of the original prescription period which, but for the suspension, would have run out on 10 March. Thus, it is only the remaining four days of that period that run after the end of the suspension.

The formula chosen to define the range of impediments leading to suspension of the running of the period of prescription ties in with III.-3:104 (Excuse due to an impediment); the comments to that provision apply.

III.-7:304: Postponement of expiry in case of negotiations

If the parties negotiate about the right, or about circumstances from which a claim relating to the right might arise, the period of prescription does not expire before one year has passed since the last communication made in the negotiations.

COMMENTS

Negotiations between the parties to reach a settlement out of court deserve to be encouraged. They should not have to be carried out under the pressure of an impending prescription of the claim. Nor should negotiations be allowed to constitute a trap for the creditor. A debtor who starts negotiating and who thus prevents the creditor from bringing an action should not later be allowed to refuse performance by invoking the time that has elapsed during those negotiations. Ultimately, the present provision has to be regarded as a special manifestation of the principle of good faith and fair dealing.

In order to minimise the effect of negotiations on prescription it is sufficient to postpone the expiry of the period of prescription rather than suspend its running (on the difference, see Comment A to III.-7:301 (Suspension in case of ignorance)). Once negotiations have failed, the creditor does not need more than a reasonable minimum period to decide whether to pursue the claim in court.

Illustration 1

A has a right to €20,000 against B. The right falls due on 10 October 2004. Between 10 October 2004 and 10 March 2005, negotiations are pending between A and B about whether the right exists. Prescription occurs on 10 October 2007; the period is not extended as a result of the negotiations.

Illustration 2

The facts are as above, but the negotiations take place between 20 December 2006 and 5 May 2007. The period of prescription is only completed on 5 May 2008 (one year after the end of negotiations).

Illustration 3

The facts are as above, but the negotiations take place between 1 September 2007 and 15 May 2008. Prescription occurs on 15 May 2009 (one year after the end of negotiations).

The term "negotiations" has to be interpreted widely. It covers any exchange of opinion which may reasonably lead the creditor to believe that the claim has not been finally rejected by the debtor. Conciliation proceedings, which appear to be of growing importance with regard, e.g., to medical malpractice suits in some countries, should also be taken as covered by the term negotiations.

The Chapter does not establish any formal requirements to clarify when the period during which prescription is delayed begins or ends. However, a debtor would be well advised to try to establish clearly when negotiations have broken down since, in accordance with general principle, it is the debtor who has to prove that negotiations have broken down. The general rules on when a notice or other communication takes effect may be relevant in this connection: the last communication in the negotiations will normally be regarded as made only when it reaches the addressee.

III.-7:305: Postponement of expiry in case of incapacity

(1) If a person subject to an incapacity is without a representative, the period of prescription of a right held by or against that person does not expire before one year has passed after either the incapacity has ended or a representative has been appointed.

(2) The period of prescription of rights between a person subject to an incapacity and that person's representative does not expire before one year has passed after either the incapacity has ended or a new representative has been appointed.

COMMENTS

A. The options

The principle that prescription does not run against a person who is unable to bring an action also requires prescription not to run against a creditor who is subject to an incapacity. The paradigmatic example is the minor who is unable because of minority to pursue a claim in court. Some legal systems, therefore, have a general rule to the effect that prescription does not run against a minor. Arguably, however, it overshoots the mark. For a minor normally has a legal representative (such as a parent or guardian) capable of bringing proceedings on his or her behalf. It is arguable, therefore, that the minor only requires protection where there is no such representative.

B. The general approach

The choice between these two approaches is not an easy one. On balance, however, commercial certainty would appear to be too gravely jeopardised if a person exposed to a claim by a minor had to wait at least until the minor had reached the age of majority plus three years. The interests of the minor cannot in this respect prevail against those of the third party, since the legal system may reasonably proceed from the assumption that the parent or guardian has a responsibility to look after the interests of the minor. This is particularly obvious in the case of rights other than those for compensation for personal injuries, such as contractual rights. If the adult representative fails to act in the appropriate manner this is a risk that the minor should bear, subject to rights against the representative. Moreover, the minor can be protected at least to the extent that expiry of the period of prescription of the minor's rights *against the representative* can be postponed until a reasonable time after the minor reaches the age of majority.

C. Person under disability without a representative

The Article specifies the situations in which protection is required. The effect of the first paragraph is confined to the situation where the minor or other person subject to an incapacity is without a representative. Two additional points have to be noted. (i) Protection of the person subject to an incapacity only appears to be necessary if the lack of representation existed within the last year of the prescription period, as long as the law makes sure that a reasonable period is available after either the incapacity or the lack of

representation has been removed. Lack of representation, therefore, does not suspend the running of the prescription period but merely postpones its expiry. (ii) The rule works both ways, i.e. it also affects rights against the person subject to an incapacity. Though not impossible, it is often not easy for the creditor of a person subject to an incapacity who lacks a representative to pursue a claim. Thus, it appears to be equitable to grant such a creditor the same protection as is granted to the person subject to the incapacity.

D. Rights between person subject to an incapacity and the representative

The second paragraph supplements the first. If, as far as third parties are concerned, a minor (for example) has to bear the consequences of the representative's failure to act, the minor must at least be able to sue the representative for damages. This the minor can normally only do on attaining the age of majority. Once again, however, it is unnecessary to suspend prescription. It is sufficient that a reasonable period is available for bringing an action after reaching the age of majority. Once again, it is equitable to make the rule work both ways.

E. Personal injuries

In some countries, sexual abuse of children has given rise to civil litigation. Here the law may arguably rely on the representative adult to take whatever action is appropriate, where the person abusing the child is an unrelated stranger. Where the person abusing the child is the parent, postponing the expiry of the period of prescription of all rights between child and parent would help, at least to a certain extent. However, the minor will often have repressed the traumatic childhood experience and may need considerable time to break down the psychological barriers preventing acknowledgement of what has happened. Thus, it may be more appropriate in these cases to suspend the running of, rather than to postpone the expiry of, the period of prescription. Moreover, there have been cases where the child is abused by another family member with whom the parent connives or whom he or she does not want to sue for other reasons. Here it might also be appropriate to introduce a rule suspending prescription – either of the rights against the third party or at least against the parent. However, this does not seem to be the place for such specialised rules, which raise difficult and emotive issues. If the rules in the Chapter are considered inadequate for this special situation, the matter would be best dealt with by special laws relating to this matter.

F. Rights between spouses

Another related matter may be mentioned here, although it is not a question of incapacity. In a number of codes, rights between spouses are subjected to the same regime as rights between children and their parents or guardians: prescription is suspended as long as the marriage persists. The common denominator is the family tie which constitutes, in the old-fashioned language of the draftsmen of the CC, a relationship of piety requiring utmost care and protection. But such a rule appears hardly defensible today. It leads to problems being swept under the carpet rather than solved. The death of one of the spouses should not enable the other to surprise disagreeable heirs by presenting them with rights which would normally have prescribed many years ago. Nor should divorce provide the trigger for settling old scores. Marriage would then have had the effect of

removing protection against stale claims: a result which may well be regarded as discriminatory. If, on the other hand, one were to regard the rationale underlying suspension concerning rights between spouses as sound, it is difficult to see why the rule should not be generalised so as to cover other closely related persons living in a common household. However, delimitation of its range of application would then become an intricate exercise which would inevitably jeopardise legal certainty. The only special rule that is required is the one concerning rights between persons under a disability and their representatives, and it is based on a different rationale: not on the close personal ties existing between these persons but on the impossibility of action by the person under the disability.

G. Adults subject to an incapacity

The previous remarks have often focused on the minor. Of course, they apply with appropriate modifications also to persons who lack the capacity to pursue claims because they are of unsound mind.

III.-7:306: Postponement of expiry: deceased's estate

Where the creditor or debtor has died, the period of prescription of a right held by or against the deceased's estate does not expire before one year has passed after the right can be enforced by or against an heir, or by or against a representative of the estate.

COMMENTS

When a person has died it can happen, at least under some succession regimes prevailing in Europe, that the estate is without a personal representative, or heir, who can sue or be sued for rights by or against the estate. It is reasonable in such a case to postpone expiry of the period of prescription on the model established for persons subject to an incapacity (III.-7:305 (Postponement of expiry in case of incapacity)). The situations are very similar, and so is the underlying rationale that prescription does not run against a person who is unable to bring an action. This applies to rights by and against the estate.

III.-7:307: Maximum length of period

The period of prescription cannot be extended, by suspension of its running or postponement of its expiry under this Chapter, to more than ten years or, in case of rights to damages for personal injuries, to more than thirty years. This does not apply to suspension under III.-7:302 (Suspension in case of judicial and other proceedings).

COMMENTS

A. Uniformity or differentiation?

The Chapter establish a core regime of a short period of prescription (three years according to III.–7:201 (General period) but, because of the rule on reasonable discoverability (III.–7:301 (Suspension in case of ignorance)), prescription may nonetheless be postponed for decades. But prescription should not be deferred indefinitely: at some stage, the parties must be able to treat the incident as indubitably closed. A maximum period after which no claim may be brought, regardless of the creditor's knowledge, appears to be necessary as a counterbalance to the discoverability principle. It is required in terms of all three policy considerations referred to above (Comment E to III.–7:101 (Rights subject to prescription)) which underlie the law of prescription. This is increasingly recognised internationally. The question is how long this maximum period should be. Once again, we observe an international trend – though not an entirely unequivocal one – towards a shorter period. But this shorter period often only applies to rights which do not involve personal injuries. Thus, taking account of the more modern codifications and reform proposals, there appear, once again, to be two fundamental options: differentiation or uniformity.

Differentiation would have to be along the line of rights to damages for personal injuries versus other rights. Most situations which have been specified as being particularly problematic (sexual abuse of children, asbestosis, medical malpractice) fall into the category of rights to damages for personal injuries. The reasons for treating them differently are that there is often a long latency period and that life, health and the bodily integrity in general are particularly valuable objects of legal protection: personal injuries are generally regarded as more serious than property damage or economic harm. For the latter even a short long-stop of ten years is very widely regarded as sufficient. There should also be no objection to subjecting other types of rights (such as rights for specific performance, or rights for the reversal of unjustified enrichment) to a ten year long-stop. For personal injuries, a long-stop of thirty years is widely regarded as appropriate. Finally, the distinction between rights to damages for personal injuries and other rights appears to be comparatively straightforward. Personal injuries are all injuries to the bodily integrity of a person. All rights arising from such injury (including, for instance, psychiatric injury and compensation for pain and suffering) are covered by the thirty-year period.

Alternatively, one might try to find a compromise solution which accommodates both rights to damages for personal injuries and other rights while not providing a perfect solution to either of them. The arguments for this option are as follows. (i) Even a thirty year period will not provide a perfect solution for rights to damages for personal injuries since there will still be cases where the creditor did not know about the claim. (ii) An incident might cause both personal injury and damage to property. For example, a defective machine explodes and damages the purchaser's health and property. Or asbestos is used in the process of renovating a house; after some years, the owner contracts asbestos-related cancer and has to undergo expensive treatment; at the same time, the

house has to be pulled down. If it is possible, after all those years, to prove who was responsible for using asbestos, and that the presence of asbestos in the house has caused the owner's disease, it is hard to see why the owner should be able to pursue rights based on injury to health but not rights based on damage to property: if the one is established, so is the other. (iii) It is as difficult for the debtor to mount a defence after twenty or thirty years in an action for damages for personal injuries as it is in an action concerning damage to property. The obfuscating power of time does not distinguish between different types of rights. Witnesses die, the debtor's memory fades and vital documents are lost. Once again, it must be remembered that we usually only see the hardship involved for a creditor who is barred by prescription although able, even after the lapse of many years, to establish the claim; and that we tend to forget about the many cases in which a prescription regime prevents unjustified claims from being pursued. (iv) One important source of rights based on personal injuries is defective products. Here we have a general long-stop (for personal injuries and damage to property) in all member states of the EU as a result of the Product Liability Directive; and it was the relatively short period of ten years which was regarded as sufficient in this situation. (This period even starts to run when the producer has brought the defective product into circulation!).

On balance, it has been decided to follow the first of these approaches and to adopt the distinction between rights based on personal injuries (long-stop of thirty years) and other rights (long-stop of ten years). However, within the framework of the Chapter, this long-stop is not, as it is usually perceived, a prescription period. This is due to the fact that discoverability is not the moment of commencement of the period of prescription. Commencement is defined in III.-7:203 (Commencement), a provision which is of general application. The running of the period of prescription is merely suspended as long as the creditor does not know, and could not reasonably know, of the facts giving rise to the right and of the identity of the debtor. Thus, the long-stop becomes in fact a rule on the maximum effect of extension of the period of prescription. As a result, we do not have two prescription periods for one and the same claim, running side by side with each other; instead, we have a uniform regime of one period of three years which may be extended to a maximum length of ten (or thirty) years. It goes without saying that the ten (or thirty) years must be counted from the time laid down in III.-7:203 (Commencement).

Any specially extended period for environmental damage must be left to special legislation.

B. Range of application

Obviously, the maximum period applies to suspension in case of ignorance. If the special need for legal certainty in this field of law is kept in mind, however, it has to apply as broadly as possible. Only reasons inherent in the nature of things should override this final date. Such reasons are apparent only in one situation: suspension in case of judicial proceedings (III.-7:302 (Suspension in case of judicial and other proceedings)). One cannot expect more of the creditor than to attempt to establish the right by judicial proceedings. How long these proceedings take is very largely a matter the creditor cannot

control. Everything is now under way to remove the existing uncertainty and it would clearly be inequitable if the creditor could be trapped by prescription in this situation.

Apart from III.–7:302 (Suspension in case of judicial and other proceedings), the maximum period laid down in the present Article applies to all grounds of suspension or postponement of expiry provided for in these Chapter, and also in situations where two or more of them apply to the same claim. It therefore provides a limit to the operation of III.–7:301, III.–7:303, III.–7:304, III.–7:305 and III.–7:306. For extension of prescription by way of agreement, see III.–7:601 (Agreements concerning prescription).

Illustration

On 10 March 2004, A observes some cracks in his house which was built by B a few years earlier. A investigates the matter and discovers (i) that the cracks are due to a defect in the foundations of the house, (ii) that B was responsible for that defect and (iii) that expensive repairs are necessary to prevent further deterioration. On the assumption that the moment triggering the period of prescription for A's right to damages for non-performance by B of B's contractual obligation (i.e. the moment of the defective performance) was 1 March 1996, the running of the period was suspended until 10 March 2004. If A and B now start to negotiate about the claim, the period of prescription can be further extended in terms of III.–7:304 (Negotiations), but not beyond 1 March 2006.

C. Fraus omnia corrumpit (fraud unravels all)?

In a number of countries, we find a general rule in terms of which the running of the period of prescription is suspended if the debtor fraudulently (or deliberately) conceals the existence of the right. Such a rule, however, appears to be unnecessary in view of the fact that the running of the period is suspended anyway, as long as the creditor does not know, and could not reasonably know, about the right. The only question of practical relevance is whether fraud (as opposed to mere ignorance) should override the long-stop. But even in this respect a special rule would do more harm than good. Whether the debtor, under certain circumstances, may be barred from raising the defence of prescription is a question of a general and complex nature which defies reduction to a simple and straightforward formula. A legal system that recognises an overriding requirement of good faith will not, in principle, deny such a possibility. Raising the defence of prescription is subject to the requirements of good faith and fair dealing. A person has a duty to act in accordance with good faith and fair dealing in, among other things, defending a remedy for non-performance of an obligation. Breach of the duty may preclude the person from relying on a defence which would otherwise have been available. Of course, it must be taken into account that prescription rules are geared specifically towards bringing about a state of legal certainty (even at the expense of individual justice) and therefore must not be interfered with lightly. Moreover, even here the lapse of time cannot be considered entirely irrelevant since, after many years have passed, it becomes increasingly difficult and unproductive to argue about whether there has been fraudulent concealment or not. Still, however, the good faith issue can arise. But if it does, it does not do so only in a clearly definable category of cases which can be grouped under the heading of fraudulent concealment of the claim. Force and fear can be

equally relevant. And even in cases where there has been neither fraud, nor force, nor fear, a debtor may in certain situations be barred from invoking prescription: particularly where the debtor has promised not to do so.

Section 4: Renewal of period

III.-7:401: Renewal by acknowledgement

(1) If the debtor acknowledges the right, vis-à-vis the creditor, by part payment, payment of interest, giving of security, or in any other manner, a new period of prescription begins to run.

(2) The new period is the general period of prescription, regardless of whether the right was originally subject to the general period of prescription or the ten year period under III.-7:202 (Period for a right established by legal proceedings). In the latter case, however, this Article does not operate so as to shorten the ten year period.

COMMENTS

A. Terminology

This Article deals with what, in civilian legal systems, would traditionally have been called "interruption", which means that the time which has elapsed before the interrupting event is not taken into account. Prescription begins to run afresh. In spite of its near universal acceptance, however, the term "interruption" (based on the *interruptio temporis* of the Roman sources) is awkward and misleading. The Article therefore talks of renewal of the period. The essence of the concept is that a new period of prescription begins to run.

Obviously, renewal is a radical interference with the period of prescription, compared to suspension of its running and postponement of its expiry. It is justified only in two cases: acknowledgement of the right by the debtor (III.-7:401 (Renewal by acknowledgement)) and acts of execution effected by, or on the application of, the creditor (III.-7:402 (Renewal by attempted execution)).

B. Acknowledgement

A debtor who acknowledges the right does not require the protection granted by prescription. Protection must, on the other hand, be granted to the creditor who may rely on the debtor's acknowledgement and refrain from instituting an action. The creditor's inactivity in this situation no longer carries the same weight, particularly in relation to any expectation on the part of the debtor that the matter is regarded as closed. Also, the debtor's acknowledgement reduces any uncertainty surrounding the claim. The only sensible way in which the law can take account of such acknowledgement is by starting a

new period of prescription. Acknowledgement is a momentary event which cannot merely have a suspensive effect.

Some legal systems require the acknowledgement to be in writing. The argument for this solution is that it promotes legal certainty. Most European codifications, however, regard an informal acknowledgement (which may be either express or implied) as sufficient. Of course, it may sometimes be difficult to interpret the debtor's conduct but these difficulties can be resolved, as with all declarations or other conduct which may have legal relevance, by having recourse to the general rules of interpretation. Moreover, even a written statement by the debtor will often be open to various interpretations. The general trend in contract law has certainly been towards informality and though we are not dealing here with a contractual declaration there is no reason to regard an acknowledgement as sufficiently serious, or special, or inherently precarious, to warrant the introduction of a form requirement. In none of the countries that recognise informal acknowledgements has the position been regarded as unsatisfactory.

Legal certainty is safeguarded sufficiently if the law requires acknowledgement of the right to the creditor. The latter cannot reasonably rely on an acknowledgement to a third party. This might well be based on considerations arising from the relationship between debtor and third party and is not sufficient evidence of any clear recognition of obligation towards the creditor.

Obvious examples of an acknowledgement by conduct are part payment, payment of interest, or the giving of security.

Illustration 1

A owes B €400. B's obligation to pay that sum is due on 10 October 2005. On 5 October 2008, B pays part of the sum and confirms that he will pay the remainder as soon as he is able to. As a result, on 5 October 2008 a new three year period starts to run for the remaining debt.

Illustration 2

A has been injured in a car accident caused by B. He has had expenses for hospitalization and medical bills amounting to €10,000 which he now claims from B. B's insurance is only willing to pay €5000. B therefore sends a cheque for €5000 stating that this is the whole amount he is prepared to pay. There is no renewal of prescription concerning the remaining €5000 since B has not acknowledged A's right so far as that amount is concerned.

The rule of III.-7::401 (Renewal by acknowledgement) also applies to a right established by judgment. However, acknowledgement of this right by the debtor does not set in motion a new ten year period. It is now the general period of three years that starts to run, though not so as to shorten the ten year period laid down in III.-7:201(General period) which is already running.

Illustration 3

A owes B €20,000. The right has been established by judgment which has become final on 10 October 1999. Four years later A acknowledges the right by part payment. Prescription still occurs on 10 October 2009.

Illustration 4

The facts are as above but the acknowledgement takes place on 10 March 2008. On that date a new period of three years starts to run.

III.–7:402: Renewal by attempted execution

The ten year period of prescription laid down in III.–7:202 (Period for a right established by legal proceedings) begins to run again with each reasonable attempt at execution undertaken by the creditor.

COMMENTS

If the creditor has obtained a judgment that has become enforceable, or any other instrument which is enforceable under the law under which it was made, the right based on such judgment, or other instrument, is also subject to prescription, though it is now the long ten year period laid down in III.–7:202 (Period for a right established by legal proceedings) that applies. As a result, the creditor's right can, once again, be threatened by prescription. The only way for the creditor to prevent this from happening (apart from extracting an acknowledgement from the debtor) is to attempt an act of execution. Such an act of execution will normally be of a momentary character and cannot, if it is to have any beneficial effect for the creditor, merely constitute a ground for suspending the running of the period or postponing its expiry. Also, the creditor has formally made clear that the right is insisted on. The act of execution therefore has to have the effect of starting a new period of prescription.

Normally, the attempt at execution will be effected on the application of the creditor by a court or public official. It is then sufficient that the creditor has made the application, as long as such application is not invalid or is not withdrawn before the act of execution has been attempted.

Section 5: Effects of prescription

III.–7:501: General effect

(1) After expiry of the period of prescription the debtor is entitled to refuse performance.

(2) Whatever has been paid or transferred by the debtor in performance of the obligation may not be reclaimed merely because the period of prescription had expired.

COMMENTS

A. "Weak" effect of prescription

Even if a legal system looks at prescription as a matter of substantive law (as the rules in this Chapter do; see the Comment B to III.-7:101 (Rights subject to prescription)), it has two options. Once the period of prescription has run out, the right may be held to have ceased to exist (strong effect of prescription); or the debtor may merely be granted a right to refuse performance (i.e. prescription constitutes a defence on the level of substantive law; weak effect). A debtor who has paid in spite of prescription having occurred, has paid with legal ground according to the latter approach and should be unable to recover; whereas the debtor should be able to recover as having paid without legal ground according to the former approach. This consequence, however, is not normally drawn by legal systems subscribing to the strong effect of prescription. Nor do all of them, as might be thought logical, regard prescription as a matter which must be taken into account *ex officio* by the court. Effectively, therefore, it is the weak effect of prescription that has been gaining ground internationally. This is not surprising. The weak effect is more appropriate in view of the aims pursued by the law of prescription. There is no reason for a legal system to foist protection on a debtor who is willing to pay and who can thus be taken to acknowledge the obligation to do so; and the public interest (*ut sit finis litium*) is not adversely affected if a debtor is allowed to pay, even after the period of prescription has run out. On the contrary, it would be detrimental to the public peace if the debtor were allowed to reclaim the payment made. Once payment has been made, even after prescription has occurred, the matter must be regarded as settled. While any prescription regime will inevitably result in creditors being unable to pursue even entirely valid claims, the law should not endorse this consequence where it is unnecessary in terms of the underlying policy objectives.

According to paragraph (1), the debtor is therefore given a right to refuse performance (a peremptory defence). This means that prescription does not operate *ipso iure*. It also means that the obligation continues to exist.

Whatever has been paid or transferred by way of performance may not be reclaimed merely because the period of prescription has expired. It may be reclaimed for other reasons - for example, if the debtor has performed under the reservation that the right had not prescribed or if the creditor had fraudulently induced the debtor to believe that the right had not prescribed.

Whether the debtor knew about the fact that prescription had occurred or not is irrelevant. The debtor who did not know that prescription had occurred still cannot recover what has been paid or transferred. The debtor who knew that prescription had occurred has still paid in discharge of an existing obligation and can, therefore, not be taken to have made a

gift (a conclusion which could be of importance in relation to, for example, claims by disadvantaged creditors).

The Chapter does not deal with the effect of prescription on security, whether real or personal.

B. Defence of prescription inadmissible

As has been pointed out already (see Comment C to III.–7:307 (Maximum length of period)) raising the defence of prescription can, under certain circumstances, be inadmissible because it constitutes a breach of the duty to act in accordance with good faith and fair dealing. This is the case, for instance, where the debtor has prevented the creditor from pursuing the right in good time, particularly where the debtor has waived the right to raise the defence of prescription. The question is of considerable practical relevance for those legal systems which prohibit agreements rendering prescription more difficult. Since they also usually regard a unilateral waiver as invalid, they can only help the creditor by having recourse to the general good faith provision. In view of the more liberal regime adopted in this Chapter (III.–7:601 (Agreements concerning prescription)) the problem is largely obviated: a waiver is no longer objectionable merely on account of the fact that the parties would not have been allowed to render prescription more difficult. Moreover, it is reasonable to assume that there will usually have been a tacit agreement. Nevertheless, the problem can still arise under the present Chapter, particularly in personal injury cases where the debtor waives the right to invoke prescription shortly before the end of the thirty year maximum period provided in III.–7:307 (Maximum length of period) and III.–7:601 (Agreements concerning prescription). Here the debtor will be barred from invoking the defence of prescription for the period that he or she has delayed enforcement of the right.

After prescription has occurred, the debtor is entitled to waive the right of invoking the defence of prescription, either by way of agreement with the creditor or unilaterally: after all, the right still exists and the waiver merely has the effect of removing the possibility of preventing it from being enforced.

III.–7:502: Effect on ancillary rights

The period of prescription for a right to payment of interest, and other rights of an ancillary nature, expires not later than the period for the principal right.

COMMENTS

Prescription occurs to prevent litigation about stale rights, both in the public interest and in order to protect the debtor. This policy would be undermined if the creditor could still sue the debtor for interest that may have become due on a right for which the period of prescription has run out; for the debtor, in order to mount a defence, might then be forced to go into the merits of the principal right itself. The same considerations apply to other

rights of an ancillary nature, such as those for emoluments and costs. Hence the need for a rule that such rights prescribe with the principal claim, even if the prescription period applicable to them has not yet expired.

III.-7:503: Effect on set-off

A right in relation to which the period of prescription has expired may nonetheless be set off, unless the debtor has invoked prescription previously or does so within two months of notification of set-off.

COMMENTS

A right that is prescribed can no longer be enforced. But it may still provide a valid basis for a right of set-off. A number of codifications contain rules to the effect that the right of set-off is not excluded by the prescription of the cross-claim, provided it could have been set off against the principal right at a time when it was not prescribed. The policy of these rules is to preserve a right of set-off that has once accrued, even though set-off has not been declared at that stage. It does not, however, fit in well with the policy considerations underlying the law of prescription. The "obfuscating power of time" affects the creditor's right in the same way, whether it is pursued by way of action or used to effect set-off. In both cases the debtor needs protection. In both cases it would run counter to the public interest if a stale right could become the object of litigation. Set-off, under the scheme of these rules, does not operate retrospectively. This simplifies matters, for we merely have to look at the moment when set-off is declared. Obviously, considering the policy of the law of prescription, it cannot be declared where the debtor (of the cross-claim) has previously invoked prescription. But since the debtor has no reason to invoke prescription unless the creditor asserts a right (whether by way of bringing an action or by declaring set-off), the debtor will have to be granted a reasonable period, after receipt of notice of set-off, to raise the defence of prescription. If the debtor fails to do so, the set-off is effective: after all, the right continues to exist in spite of the prescription period having run out.

Illustration

A has sold B a car for €15,000. The car is delivered to B on 1 October 2005. On the same day A's right to receive the purchase price falls due. In September 2007 the car is involved in an accident caused by a defect in the brakes for which A was responsible. B suffers damage to the extent of €17,000. The period of prescription of B's right against A started to run on 1 October 2005 (the day of non-performance) but its running was suspended so long as B was unaware of the defect (until September 2007). If B sues A for damages before 1 October 2008, A can set off his own right for the purchase price. He may do so even when he is sued after 1 October provided B does not invoke prescription within two months of having received notice of set-off.

Section 6: Modification by agreement

III.-7:601: Agreements concerning prescription

(1) The requirements for prescription may be modified by agreement between the parties, in particular by either shortening or lengthening the periods of prescription.

(2) The period of prescription may not, however, be reduced to less than one year or extended to more than thirty years after the time of commencement set out in III.-7:203 (Commencement).

COMMENTS

A. Agreements rendering prescription more difficult

The parties may wish to contract out of the prescription regime. This can happen in a number of ways. They may want to extend or shorten the period of prescription applicable to the right; they may want to change the date when the period begins to run; they may want to add to, or subtract from, the list of grounds of suspension, and so on. Agreements rendering prescription more difficult are generally considered to be more objectionable than agreements facilitating prescription. These objections are usually based upon the public interest which the prescription of rights is intended to serve. It must, however, be remembered that the prescription of rights predominantly serves to protect the debtor and that, where the debtor renounces such protection, private autonomy may well be seen to prevail over the public interest. Also, the general prescription periods applying in countries objecting to agreements rendering prescription more difficult are comparatively long (ten, twenty, or thirty years) so that a further lengthening may indeed be problematic; much more problematic, at any rate, than where there is a short general prescription period. Widely, therefore, agreements lengthening the period are specifically admitted, where the period is, exceptionally, a short one. Contractual warranties concerning latent defects in buildings or goods can have that effect and provide an obvious and practically important example. Equally, it tends to be accepted that the prohibition does not affect agreements which indirectly render prescription more difficult, such as agreements postponing the due date of a claim, or *pacta de non petendo* (agreements allowing additional time for performance). However, it is not easy to see why the parties should not be able to postpone the commencement of the period of prescription as such if they can postpone the due date of the claim. Moreover, these subtle distinctions provide ample opportunity for effectively circumventing the prohibition. These problems are obviated by abandoning the prohibition.

This appears all the more desirable under a system of prescription such as the one proposed in this Chapter. Party autonomy provides the necessary counterbalance to (i) the short general prescription period of three years and (ii) the uniformity of the regime in general. Neither the three year period nor a number of the other rules fit all types of rights and all imaginable situations equally well. The parties must be free to devise a more

appropriate regime, as long as they observe the general limitations placed on freedom of contract. The rules in this Chapter rest on a delicate balancing of interests and it must be recognised that a reasonable balance could conceivably be achieved in an entirely different way. The parties to a contract may, for example, quite reasonably regard suspension in case of ignorance as a source of uncertainty and they may wish to balance the exclusion of this rule by providing for a longer period.

B. Restrictions

Two provisos have to be made. (i) Standard contract terms interfering with the prescription regime must be scrutinised particularly carefully. The rules on unfair contract terms provide the necessary tool. (ii) Public interest does not require a prescription regime to be mandatory: party autonomy may, to a large extent, prevail. The public interest is not adversely affected if a right prescribes in seven rather than three years; not sufficiently adversely affected, at any rate, to override the decision of a debtor to waive this protection by agreement with the creditor. The debtor should not, however, be able to agree upon a period of fifty, or one hundred, years since that would effectively exclude the right from prescription. This is why the present Article provides that prescription cannot be extended by agreement beyond a period of thirty years. Thirty years constitute the longest period envisaged in this Chapter under exceptional circumstances (maximum period of extension in cases of personal injuries rights: III.–7:307 (Maximum length of period)) and one which is, at present, still applicable as a general period in a number of member states. The thirty years are to be counted from the general time of commencement of prescription, as laid down in III.–7:203 (Commencement).

C. Agreements facilitating prescription

What has been said above applies with even greater force to agreements facilitating prescription. They are much more widely recognised even today; moreover, they do not conflict with the public interest based policy concerns underlying the law of prescription. Nonetheless it has been regarded as equitable also to fix a minimum limit for party autonomy. This limit is a period of one year. It applies even to individually negotiated agreements between professional parties.

BOOK IV

SPECIFIC CONTRACTS AND THE RIGHTS AND OBLIGATIONS ARISING FROM THEM

PART A. SALES

CHAPTER 1: SCOPE OF APPLICATION AND GENERAL PROVISIONS

Section 1: Scope of application

IV.A.-1:101: Contracts covered

- (1) This Part of Book IV applies to contracts for the sale of goods.*
- (2) It applies with appropriate adaptations to:*
 - (a) contracts for the sale of electricity;*
 - (b) contracts for the sale of stocks, shares, investment securities and negotiable instruments;*
 - (c) contracts for the sale of other forms of incorporeal property, including rights to the performance of obligations, industrial and intellectual property rights and other transferable rights;*
 - (d) contracts conferring, in exchange for a price, rights in information or data, including software and databases;*
 - (e) contracts for the barter of goods or any of the other assets mentioned above.*
- (3) It does not apply to contracts for the sale or barter of immovable property or rights in immovable property.*

COMMENTS

A. Main application: contracts for the sale of goods

This Part of Book IV applies primarily to contracts for the sale of goods. It is not concerned with the formation, validity or interpretation of such contracts. Such questions are left to the general rules in Book II. It is concerned mainly with the effects of such contracts on the rights and obligations of the parties. There are good reasons for giving

special attention to the rights and obligations of the parties under contracts for the sale of goods. Not only has the contract for the sale of goods served as the paradigm for contracts in general, but it is also probably the most common contract, and certainly the most common consumer contract, that there is. In fact, sales come in all shapes and sizes: ranging from the purchase of the daily newspaper at the news-stand or the groceries in the supermarket, through to the purchase of a new car and to commodity sales on highly specialised markets. Moreover, there are many mixed transactions that contain a certain element of sale, such as distribution contracts or all sorts of manufacturing contracts.

A “contract for sale” is defined in IV.A.–1:202 (Contract for sale). The term “goods” is defined in Annex 1 as follows.

“Goods” means corporeal movables. It includes ships, vessels, hovercraft or aircraft, space objects, animals, liquids and gases.

For future goods, see also IV.A.–1:201 (Goods).

B. Application with appropriate adaptations

According to IV.A.–1:201 (Goods) goods are defined as ‘corporeal movables’. The sale of other types of property or assets involves different problems that are not regulated by this Part. Moreover, sales contracts dealing with any of the assets listed in paragraph (2) may not be subject to all the rules contained in these rules, e.g. conformity requirements in respect of shares sold. Therefore paragraph (2) provides that the rules in this Part may be applied to sales of certain types of assets provided that appropriate adaptations are made (see Comment C). This formula is used because the nature and the huge variety of transactions falling under this extended scope of application make it virtually impossible to provide an exhaustive list of which rules apply and which do not.

It should be noted that the extension of the scope provided by paragraph (2) is not restricted to sales contracts as it also applies to certain contracts which are very similar to sale. It applies to contracts conferring rights in information or data which are functionally equivalent to sale but are not technically contracts for “sale” because no ownership is transferred (paragraph (2)(d)). It also applies to contracts for barter (paragraph (2) (e)) whether relating to goods or to the other assets mentioned in the paragraph (e.g. exchanging electricity for gas).

C. Other assets

The types of assets listed in paragraph (2) have in common that they are, at least to a certain extent, incorporeal (cf. the reference to other forms of incorporeal property in (c)). By selling shares, for instance, one sells a bundle of rights. There may not be any transfer at all of a paper certificate. Indeed with the increase in the electronic issuing of shares, paper certificates are much less common than formerly. Likewise, a standard computer program can be downloaded directly without involving a durable medium such as a CD.

The list in this Article is exhaustive and contains the following assets:

Electricity. Taking the European and national trends towards the further deregulation of energy markets into account, these rules also apply to the sale of electricity, albeit subject to appropriate adaptations. One of the practical problems is the fact that energy does not possess a material aspect, which can, however, be remedied by measuring the amount of use (electric energy, heat). It should be noted that gas, steam and oil, already fall under the definition of “goods” in Annex 1.

Stocks, shares, investment securities and negotiable instruments. These rules do not apply directly to sales of shares, investment securities and negotiable instruments because, again, many of them are inappropriate for such direct application. When shares are sold to a buyer there is normally, for example, no undertaking that the shares will be fit for the buyer’s purpose (such as a high income yield), even if the buyer’s purpose is indeed known to the seller. Nonetheless, other rules may be applied with appropriate adaptations. It does not matter whether a few shares or a majority of shares are sold. Since the latter type of transaction may result in the sale of a controlling interest in a company, the transfer of the shares actually also results in the sale of the enterprise. These rules may therefore also be applied, indirectly and with appropriate adaptations, to the sale of enterprises.

Other forms of incorporeal property. The rules in this Part of Book IV apply with appropriate adaptations to contracts for the sale of other forms of incorporeal property, including rights to the performance of obligations, industrial and intellectual property rights and other transferable rights. The reason for this broad provision lies in the fact that it is virtually impossible to provide a list of proprietary, transferable rights that can be sold under the different legal systems. Examples of such rights are: security rights; split-property rights; usufructs; pledges; co-operative rights; mortgages; debt claims; an inheritance or parts thereof; rights in immaterial goods, such as patent rights; rights arising from the registration of trademarks; and rights to the performance of obligations generally.

Information and data (including software). Paragraph (2)(c) applies the rules of this Part of Book IV “with appropriate adaptations” to contracts conferring, in exchange for a price, rights in information or data, including software and databases. The reason for using this form of words rather than the simple “sale” is that the definition of a contract for sale requires an undertaking to transfer ownership (see IV.A.–1:202 (Contract for sale)). There may be no such undertaking in the types of contracts under consideration. Of course, these rules may sometimes be applied to an outright sale of software or proprietary information, namely when the intellectual property rights are sold. Generally, however, although it is common to speak of ‘selling’ or ‘buying’ software, in fact the ‘buyer’ is often merely given a licence to use the software. In such a case, there is no transfer of ownership, and hence these rules are not directly applicable. Nonetheless, some of the underlying principles of the rules may be relevant to such transactions. For example, the rules on conformity may provide a useful guideline as to what obligations

the ‘seller’ of software should be subject to. In one respect, however, ‘sales’ of software are covered directly by the rules. Many types of equipment are now wholly or partly controlled by microprocessors which are an integral part of the equipment. These microprocessors are in turn controlled by pre-loaded software. This ‘embedded’ software (for example, the programmes that control the electronic ignition of a car or its braking system) is simply treated as part of the goods for the purposes of these rules. While the sale of personal data is restricted due to data protection rules established by European Directives and other standards, it cannot be overlooked that information and data are ‘sold’ on a daily basis. The crucial point is to draw the borderline between the mere sale of information as opposed to the supply of information under a specific service contract. In some cases the distinction may be difficult to draw. In practice, this question of qualification is not of great importance as regards conformity, since the obligations of the seller or the service provider will be similar. Besides, if there is a deviation in substance between the regulation of sales and services, the solution used in Part IV.C on Services Contracts can still be applied if it is more appropriate, since the sales rules may be applied with appropriate adaptations concerning this kind of contract.

Illustration 1

The rules in this Part may be applied to the sale of standardised information, i.e. information already available and not custom-made: for instance, the sale of an electronic version of case law decisions on Lexis.

D. Immovable property

These rules do not apply to the sale of immovable property (paragraph (3)) or rights in such property. As a consequence, rights in land, buildings or other immovable property do not fall within their scope.

E. Relationship with Books I to III

The rules in Books I to III serve as the general part of the law applicable to sales transactions. Thus, issues of general contract law – such as formation, validity, effects etc. – have to be resolved by applying the provisions of Book II. The rules on the performance of obligations in general, including those of a seller or buyer, and on the remedies for non-performance of obligations in general will be found in Book III. Some of these rules are, however, modified or supplemented by the rules in this Part.

IV.A.–1:102: Goods to be manufactured or produced

A contract under which one party undertakes, for a price, to manufacture or produce goods for the other party and to transfer their ownership to the other party is to be considered as primarily a contract for the sale of the goods.

COMMENTS

A. General

Many contracts involve the seller producing or manufacturing the goods before their ownership can be passed to the buyer in exchange for a price. If there is no undertaking to construct, but it just incidentally happens that the seller will construct the goods before selling them, then there is a pure contract of sale and this Article will not apply. It applies only where under the contract one party actually “undertakes” to manufacture or produce the goods. Under the rule in this Article such a contract is to be considered as primarily one of sale of the goods. It does not matter that the goods do not exist at the time when the contract is concluded. These rules apply to a sale of future goods (see IV.A.–1:201 (Goods)). This applies whether the goods are to be mass-produced or are to be custom-built to an agreed design, like a ship.

There are two parties involved in such a transaction: the party who orders the goods to be manufactured or produced and who undertakes (either expressly or impliedly) to buy them, and the party who undertakes to manufacture or produce them and then transfer their ownership to the first party. Their contract contains two elements, that of the actual manufacture or production of the goods, and that of the transfer of ownership of these goods for a price. While the former part of the transaction may be considered a service contract, the second part, i.e. the transfer of goods for a price, may well be qualified as a proper sales contract. In fact, the only difference with the majority of sales of typically mass-produced goods is that the manufacturing process has yet to take place. It is the combination of this process with the subsequent ‘sale’ that gives rise to problems of qualification.

This is but one example of a “mixed contract” combining elements of two or more specific types of contract. This Article must therefore be read, and is designed to be read, along with the general rules on mixed contracts in Book II.

B. The rules on mixed contracts

The normal rule under II.–1:108 (Mixed contracts) is that the rules applicable to each relevant category apply, with any appropriate adaptations, to the corresponding part of the mixed contract and the rights and obligations arising from it. This will often be relevant for contracts which contain provisions for the sale of goods plus something else. For example, if a contract provides for the sale of machinery and for an after-sale maintenance service for a number of years, the sale part would be governed by the rules in this Part of Book IV and the maintenance part would be governed by the rules in the Services Part of Book IV. In the absence of any special provision for contracts providing for goods to be manufactured or produced for a person and then sold to that person, the same general rule would apply: the services rules would apply to the services part and the sales rules to the sales part. Experience has shown, however, that it is more convenient to regard most such contracts as sales contracts, particularly in the case of an order for the production and sale of standard mass-produced items where the ordering party has no

input into the manufacturing process. As pointed out above, such contracts are functionally just like ordinary sales contracts except that the goods are yet to be made instead of already made. So there is a special rule under II.–1:108 (Mixed contracts) for cases where (as here) “a rule provides that a mixed contract is to be regarded as falling primarily within one category”. In such a case the rules applicable to the primary category apply to the contract and the rights and obligations arising from it. However, rules applicable to any elements of the contract falling within another category apply with any appropriate adaptations so far as is necessary to regulate those elements and provided that they do not conflict with the rules applicable to the primary category.

What this means in the present context is that in a case where the service element in a contract for the manufacture and sale of goods is pronounced – for example, where a prototype or unique item is being constructed under the active direction of the party ordering it – the rules of Part IV.C on Services could be applied with any appropriate adaptations to the services part of the contract. This is necessary, or at least highly desirable, because in some such contracts the services part may last for years and involve many difficulties. There is every reason to apply the normal services rules to the solution of such difficulties in the absence of provision in the contract itself. In any case of conflict, however, the sales rules would prevail. Conflict is likely only at the end of the process when the rules on conformity might differ slightly. It is reasonable to allow the sales rules to prevail at this stage because ultimately what the party wants is to get conforming goods just as in any other case of sale.

There is a further provision in II.–1:108 (Mixed contracts) paragraph (5) which preserves the application of any mandatory rules. So all the mandatory consumer protection rules in this Part would apply notwithstanding the mixed nature of the contract. This is essential because otherwise it would be too easy to escape from these protective rules by qualifying a contract as sale plus something else.

It does not matter who supplied the materials, provided that there was an obligation to transfer ownership of the goods, once made, to the party ordering the goods. This means that a contract under which one party is to supply materials (or most of them) and the other is to construct something out of them (acquiring ownership of the new thing in the process) and then transfer the ownership of the new thing to the ordering party is primarily one of sale. The sales rules on conformity, notification of non-conformity, passing of risk and remedies will apply. The construction rules would apply only in an incidental and subsidiary way so far as was necessary to regulate the construction part of the contract.

Illustration 1

A company orders uniforms to be made for its employees. Whether the company supplies none of the materials, or some (say only the buttons and emblems) or all of the materials, is irrelevant. If the tailor becomes the owner of the finished uniforms and transfers that ownership to the company (as would generally be the case) the rules of this Part of Book IV apply, although the services rules may

apply in a subsidiary way to the manufacturing stage (for example, if the company gave directions for a change in the work as it proceeded).

Of course, if the company supplied all the materials and the contract provided that the ownership of the materials at all stages up to and including the finishing of the uniforms was to remain with the company and was not to pass to the tailor then this would not be a contract for sale at all but simply a contract for the provision of a service. The important question is what has to be done under the contract, not who may have supplied the materials. In some cases the contract may provide for the sale of a very valuable item, even if the raw materials supplied by the maker were not of great value. The purchaser of such an item is entitled to expect that the sales rules on delivery, conformity and so on will apply.

Illustration 2

A, a famous artist, contracts with B, a wealthy merchant, to paint his portrait and transfer the ownership of the finished painting to him. This falls under the present Article. Once the portrait is made the sales rules will apply. The services rules will apply subsidiarily to the painting stage of the performance.

In practice it will generally make little difference whether the case is one which falls within this Part or within the rules on construction or processing in Part IV.C. In most cases the obligations of the seller and the constructor or processor will be similar.

C. Consumer transactions

Under the Consumer Sales Directive (1999/44/EC) article 1, paragraph (4) contracts for the supply of consumer goods to be manufactured or produced are deemed to be contracts of sale for the purpose of the Directive. It does not matter who supplies the materials or a substantial part of the materials. The present Article follows the same approach (and not just for consumer transactions) but introduces an element of flexibility by using the word “primarily” and thereby allowing the services rules to apply subsidiarily where necessary. As noted above (Comment B) the sales rules prevail in case of conflict and mandatory consumer protection rules are expressly preserved.

There is a slight blurring of the distinction between consumer contracts for sale and services in IV.A.–2:304 (Incorrect installation in a consumer contract for sale) paragraph (a), which treats the incorrect installation of goods by the seller or under the seller’s responsibility – no doubt a service – as a lack of conformity of the goods as such (see Comment B to that Article).

D. Price can be a global one

It is not necessary under this Article to find a part of the price which applies to the transfer of ownership as opposed to the carrying out of the construction or manufacturing service or to allocate a part of the price to the transfer. The price can be a global one. The contract will still be primarily one of sale and primarily regulated by these rules.

E. Immovables not covered

The Article applies only in relation to “goods”. Accordingly, contracts for the construction and sale of buildings or other immovables, arguably the most important consumer contracts when it comes to construction, fall outside the scope of this Part.

F. Repair or maintenance not covered

It must also be kept in mind that this Article applies only to contracts under which there is an undertaking both to produce or manufacture goods and to transfer their ownership. This therefore excludes contracts for the repair or maintenance of goods from its scope.

Illustration 3

The parties enter into a contract for the repair of a car engine. The mechanic takes the engine apart and rebuilds it using some of the existing parts and some new parts obtained from the manufacturer. This is either a pure services contract or (depending on whether there is an actual undertaking to sell any of the parts as opposed to a mere understanding that ownership will pass by accession) a mixed contract for services and sale. In either case it is not governed by the present rule. It will be entirely or predominantly regulated by the services rules (see II.–1:108 (Mixed contracts) paragraph (3)(b)).

IV.A.–1:103: Consumer goods guarantees

Chapter 6 applies to consumer goods guarantees associated with contracts for the sale of goods.

COMMENTS

These rules also apply to consumer goods guarantees associated with contracts for the sale of goods. Such guarantees are regulated in Chapter 6. They have to be mentioned separately here because they are not in themselves contracts for the sale of goods or other relevant assets.

Section 2: General provisions

IV.A.–1:201: Goods

In this Part of Book IV:

- (a) the word “goods” includes goods which at the time of the conclusion of the contract do not yet exist; and*
- (b) references to goods, other than in IV.A.–1:101 (Contracts covered) itself, are to be taken as referring also to the other assets mentioned in paragraph (2) of that Article.*

COMMENTS

A. Goods

Because the term “goods” is used not only in this Part but also elsewhere in these model rules it is not defined here but in the general list of definitions in Annex 1. The definition is quite short.

“Goods” means corporeal movables. It includes ships, vessels, hovercraft or aircraft, space objects, animals, liquids and gases.

The present Article makes it clear that future goods are covered in the present Part and that references to “goods” are to be taken as covering also the other assets mentioned in the first Article. This avoids the constant repetition of phrases such as “goods and other relevant assets”.

B. Corporeal movables

The basic meaning of “goods” is corporeal movables. It follows that land, buildings and other types of immovable property fall outside the ambit of the rules in this Part. This is expedient, given the complex and often diverging issues related to the sale of land, buildings or other immovable property throughout Europe. Sales of immovable property are in several systems regulated separately from sales of goods. Moreover, there are often formal requirements for the validity of a contract for the sale of land or other immovable property.

The second sentence of the definition of “goods” in Annex 1 lists certain specific items as being included within the concept of goods. This is to make it sufficiently clear that they, while falling outside the scope of some domestic and international sales laws, are deemed to be goods for the purposes of the present rules. These objects are the following.

Ships, vessels, hovercraft or aircraft and space objects. These objects have been excluded from the CISG in order to avoid questions of interpretation as to which ships, vessels (hovercraft) or aircraft are subject to the CISG, especially in view of the fact that the relevant place of registration might not be known at the time of the sale. However, they fall within the scope of the present rules, as they are clearly corporeal movables, notwithstanding the fact that their transfer may require certain formalities, such as registration.

Animals. During the last few decades, the legal status of animals, and in particular their protection, has been discussed and subsequently improved throughout Europe. As a result, many legal systems have adopted legislation to address the legal status of animals, such as rules relating to the trade in endangered species, mistreatment and health or hygiene requirements. While animals may therefore be considered to be something

different from regular ‘goods’, contracts for the sale of animals nonetheless follow the same rules as any regular sales contract.

Liquids and gases. There is no doubt that liquids and gases fall under the scope of sales rules when packaged or otherwise contained, e.g. water in bottles or gas in canisters. However, this may be more controversial when it comes to contracts for the supply of liquids and gases via pipes. While such contracts certainly contain an element of sale in respect of the amount actually supplied, they may also involve a certain element of services, such as maintenance provisions. Notwithstanding this, the present rules apply to the actual sale part of the contract.

Illustration 1

In the wake of the privatisation programme of the municipality, A concludes a contract with W, a local water company, for the supply of fresh mountain spring water through the public water pipe grid. Due to a faulty filter in the reservoir, the water remains visibly dirty, and thus undrinkable, for two days. Chapter 4 of this Part answers the question of which remedies are available to A.

It should be noted that a contract to permit one party to extract liquids or gases from the land of another will not be a contract of sale within these rules.

C. Future goods

According to sub-paragraph (a) of the present Article, the term “goods” includes so-called future goods for the purposes of this Part. Therefore parties are free to conclude a valid sales contract concerning goods that are not yet in existence.

Illustration 2

At the beginning of spring, A, the owner of an orchard, sells the current year’s future harvest to B, the local farming co-operative. Whether the contract is for the quantity of crop that A anticipates, but is subject to defeasance to the extent that there is a shortfall, or whether it is for whatever quantity is produced, it is still a contract of sale within these rules.

This solution ensures that, while future goods may have a distinct legal character in some national legal systems, they are not treated any differently from other goods. It is important to note that IV.A.–1:102 (Goods to be manufactured or produced) already addresses an important example of a contract dealing with future goods, i.e. goods which are still to be manufactured or produced.

However, a contract under which one party agrees to pay the full price even if no goods are produced is not a contract of sale within these rules.

Illustration 3

At the beginning of spring, A, the owner of an orchard, sells the current year's future harvest to B, the local farming co-operative. If B agrees to pay the full price whatever quantity is produced, in other words to buy the mere chance of A producing a harvest this year rather than the actual produce, a different type of contract comes into being.

This illustration makes it clear that it is ultimately the contract that will decide whether the buyer has to pay the price irrespective of the contingency occurring, i.e. the question of the goods coming into existence.

D. Goods extra commercium

Under many systems there are things that are extra commercium, which may not be sold at all. Examples of this are parts of the human body: cells, body parts, organs etc. These rules do not deal with such issues; they must be regulated by national law. However, it cannot be overlooked that some body parts, for instance hair, can generally be sold and a contract for the sale of such parts will fall under these rules.

IV.A.-1:202: Contract for sale

A contract for the “sale” of goods is a contract under which one party, the seller, undertakes to another party, the buyer, to transfer the ownership of the goods to the buyer, or to a third person, either immediately on conclusion of the contract or at some future time, and the buyer undertakes to pay the price.

COMMENTS

A. Definition of sale

The definition of a contract for the sale of goods is rather short and simple, as it merely addresses the main obligations of the parties, i.e. the transfer of ownership on the part of the seller and the payment of the price on the part of the buyer. This definition reflects the essence of the contract for the sale of goods: the transfer of ownership from the seller to the buyer, or a third party, for a price. The CISG and the Consumer Sales Directive as instruments of international sales law do not contain such a definition. In contrast, most national sales laws do contain a definition and it seems appropriate to include one in the present rules. The term “goods” is defined in Annex 1, as supplemented for present purposes by IV.A.-1:201 (Goods).

C. Parties to the sales contract

Normally, a sales contract involves two parties, the seller and the buyer, who are defined by their main obligations. Accordingly, the seller undertakes to transfer the ownership of goods, whereas the buyer undertakes to pay the price. The present rules apply regardless of whether the parties are professionals or consumers. For consumer contracts for sale

(see IV.A.–1:204 (Consumer contract for sale)), the general provisions are sometimes modified. Sometimes, third persons are involved in a sales transaction, for instance a carrier transporting the goods, another party already holding the goods to be sold, or someone to whom delivery is to be made. Where necessary, the present rules have taken into account such involvement by third persons (e.g. IV.A.–2:201 (Delivery), IV.A.–2:204: (Carriage of the goods), IV.A.–2:303 (Statements by third parties), IV.A.–5:203: (Goods sold in transit), IV.A.–6:101: (Definition of a consumer goods guarantee)).

D. Obligation to transfer ownership

The main obligation on the part of the seller is to transfer ownership of the goods. The definition of the contract for the sale of goods covers only the full transfer of ownership. The present rules do not apply to contracts under which the transferee is to receive only a lesser right, such as the right to use goods under a lease. However, the subsequent sale of such a right, and also of any split property right, may fall under IV.A.–1:101 (Contracts covered) paragraph (2)(c).

By including both cases in which the seller is to transfer ownership immediately and those in which ownership is to be transferred at some future time, paragraph (2) ensures, first of all, that the present rules apply both to sales transactions where ownership passes immediately on conclusion of the contract, for instance at supermarkets, petrol stations or other self-service stores, and to sales transactions where this is not the case, for instance when the contract concerns the sale of goods that are not yet in existence or contains a retention of ownership clause.

This definition has a second point. The present rules do not govern the issue of when ownership of the goods passes between seller and buyer. This is left to be determined by the rules of Book VIII on the Acquisition and Loss of Ownership in Movables.

The seller may have to transfer ownership in the goods either to the buyer or to a third person (e.g. in the case of ordering flowers to be delivered to someone else). The reference to “a third person” in this Article makes clear that both transactions are covered by the present rules.

E. Obligation to pay the price

The main obligation on the part of the buyer is the payment of the price, which is elaborated in Chapter 3, Section 2 (Payment of the price). The payment of the price does not have to coincide with the transfer of the ownership of the goods. Therefore sales contracts where the buyer may have to pay the full price some time after the delivery of the goods, for instance in consumer credit agreements, are also covered by these rules.

IV.A.–1:203: Contract for barter

(1) A contract for the “barter” of goods is a contract under which each party undertakes to transfer the ownership of goods, either immediately on conclusion of the contract or at some future time, in return for the transfer of ownership of other goods.

(2) Each party is considered to be the buyer with respect to the goods to be received and the seller with respect to the goods or assets to be transferred.

COMMENTS

A. General

The essence of a contract for the sale of goods is the transfer of ownership of goods for the payment of a price. However, there are also contracts where goods are not exchanged for money, but for other goods.

Such barter transactions are quite similar to sales contracts, as both deal with the transfer of ownership of goods from one party to the other in exchange for a counter-performance. Therefore this Article extends the scope of the present rules to barter contracts, thus reflecting the majority of the national sales laws.

There are two parties involved in such a transaction, who both act as buyer and seller at the same time. This is made clear by paragraph (2), which considers each party to be the buyer with respect to the performance to be received, and the seller in respect of the performance to be effected.

B. Application with appropriate adaptations

It is in the nature of barter contracts that certain provisions of the present rules do not apply. This is already taken into account by IV.A.–1:101 (Contracts covered) paragraph (2)(e), which declares that these rules are applicable with appropriate adaptations. In essence, this restriction relates to the provisions concerning the price (see Chapter 3, Section 2) and connected issues, such as the buyer’s remedy of a price reduction.

C. Mixed contracts of sale and barter

A pure contract for barter involves no money, as goods are exchanged for goods. However, barter and sale contracts may be mixed: A contract may contain elements of both.

Illustration 2

A buys from a mobile phone seller the latest mobile phone. The seller informs him that, in a few weeks time, a new model will be on the market with an integrated camera. A can exchange the mobile phone for this new model if he is

willing to pay an extra charge of 15 Euro. In this case we can speak of a contract with a preponderant barter element but also with a sale element.

Illustration 3

A contract under which an old car is traded in when a new car is bought is a typical example of a mixed contract for sale and barter. If there is indeed only one contract (which there need not be, as the parties could choose to conclude two separate contracts for sale and use set-off to reduce the price payable for the new car) then it is a contract with an element of sale, because the seller of the new car undertakes to transfer ownership of it and the buyer undertakes to pay a price, albeit a reduced price. However, there is also an element of barter in so far as each party undertakes to transfer ownership of a car in exchange for a transfer of ownership of the other car, albeit that the buyer of the new car has to pay a reduced price as well.

A contract of the type mentioned in either of these Illustrations will be a mixed contract within the meaning of II.-1:108 (Mixed contracts). There is a sale element and a barter element. So the sale rules will apply to the sale part and the barter rules to the barter part. (If one element is so preponderant and the other so minor that it would be unreasonable not to regard the contract as falling primarily within one category, then the rules applicable to the primary category will be primarily applicable and the other rules will apply only in a subsidiary and subordinate way and only so far as necessary to regulate the minor element (see II.-1:108 (Mixed contracts) paragraphs (3)(b) and (4)). However, by declaring the present rules applicable to barter contracts, the question of qualifying such mixed contracts or assessing the preponderance of their respective parts, loses its significance. The sale rules and the barter rules are the same for all practical purposes. By the same token, it is ensured that, as long as there is counter-performance (i.e. a price to be paid or goods to be exchanged), contracts for the transfer of ownership in goods follow the same rules.

IV.A.-1:204: Consumer contract for sale

For the purpose of this Part of Book IV, a consumer contract for sale is a contract for sale in which the seller is a business and the buyer is a consumer.

COMMENTS

A. Consumer contracts for sale

The present rules start from the idea of a uniform regime for all kinds of sales transactions, complemented by specific rules for consumer contracts for sale, i.e. when a business seller is selling goods to a consumer buyer.

The qualification of a contract as a consumer contract for sale has several consequences for the application of the present rules. First, certain provisions apply exclusively to consumer transactions, while others are excluded for consumer purposes (for an overview, see Comment D). Secondly, some rules are declared to be mandatory when the contract is a consumer contract for sale. By doing this, the present rules ensure a high level of consumer protection similar to that established by European consumer law. The main purpose of the rules protecting consumers is to protect a party who may be regarded as the weaker party in the transaction involved.

By virtue of IV.A.–1:101 (Contracts covered) paragraph (2) the rules in this Part apply with appropriate adaptations to certain contracts going beyond sale of goods. It follows that the present Article applies with appropriate adaptations to consumer contracts for barter, and to consumer contracts for sale or barter relating to the assets other than “goods” mentioned in that paragraph. Thus the present rules have a wider scope of application than the Consumer Sales Directive. Also in so far as a contract for the manufacture or production of goods and their sale to the person ordering them is a contract for sale (see IV.A.–1:102 (Goods to be manufactured or produced) it will be a consumer contract for sale if the ordering party is a consumer and the mandatory consumer protection rules will apply.

B. The notion of unitary sales law

As pointed out above, the present rules have been drafted as a uniform set of rules covering the entire spectrum of sales transactions from the manufacturer to the retailers down to the final consumers.

This approach of regulating commercial and consumer transactions within one regime has advantages. First, it presents a more coherent and concise set of solutions than a fragmented approach with different rules for different types of sale contract and with the attendant risk of duplication and unnecessary inconsistencies. Secondly, it reflects the fact that consumer contracts for sale and commercial sales may be viewed as being inter-linked, since consumer transactions often constitute the bottom end of the chain of distribution, which aims to bring goods from the manufacturers to the end-users.

The present rules have not produced a completely separate body of rules for commercial sales, i.e. those involving only businesses. Most rules have a general application, with some additional rules and some deletions for consumer contracts for sale. There are several reasons for this policy choice. First, the regulatory trend in Europe seems to be heading towards a mere dichotomy between consumer and non-consumer contracts for sale. Secondly, there is in practice almost as great a diversity within commercial sales as there is between commercial and consumer contracts for sale. This is because some commercial transactions have developed into a specialised field with separate rules and marketplaces, such as the commodity trade. Thirdly, commercial parties rely heavily on standard contracts and terms when doing business, such as the INCOTERMS, which address issues which are specific to commercial transactions.

One Article, however, (IV.A.–4:302 (Notification of lack of conformity)) applies only to contracts between businesses. This is because it is designed particularly for purely commercial sales.

C. Notion of consumer and business

The notions of a “consumer” and a “business” are used elsewhere in these model rules and not only in the Part. Accordingly they are defined in Annex 1. The definitions are as follows.

A “consumer” means any natural person who is acting primarily for purposes which are not related to his or her trade, business or profession.

“Business” means any natural or legal person, irrespective of whether publicly or privately owned, who is acting for purposes relating to the person’s self-employed trade, work or profession, even if the person does not intend to make a profit in the course of the activity.

The definitions of consumer and business used here reflect the common features of the definitions offered by various European consumer protection instruments.

Concerning the consumer definition, there are, in principle, two ways of describing the purpose of a natural person’s actions. The purpose could either be that the natural person acts for personal, family or household use (i.e. a positive description) or that he or she acts for purposes which are outside his or her trade, business or profession (i.e. a negative description). In most cases, but not always, both ways of describing the purpose will lead to the same result. An example is when the natural person concludes a contract of sale in his or her own name and where the purpose is that the goods should be used by a non-profit organisation of which the person is a member. In this case the purpose is outside the buyer’s trade, business or profession, but the transaction has not been made for personal, family or household use. In order to include such situations in the definition, thus enabling natural persons worthy of protection to be also protected in borderline cases, the negative description has been opted for under these rules. The decisive factor ought to be whether or not the natural person is acting outside his or her professional sphere.

Such a negative definition also covers cases where the purpose of the transaction is to earn the natural person a profit, e.g. where the purchase of goods is made with a purpose of making a profit. However, if the purpose is to immediately resell the goods, the transaction could be regarded as having been made within the person’s trade or business if he or she carries out several such transactions during a relatively short period of time. The main reason for including such cases is that the natural person, as long as not acting to a greater extent within his or her professional sphere, should be protected as a consumer as the reasons for protecting consumers as such are equally valid in this case. The approach chosen here is therefore that a transaction should be regarded as a

consumer transaction if the natural person has acted primarily outside his or her trade, business or profession.

Illustration 1

A buys a yacht from a professional seller of boats at a marina. His purpose is to use the yacht during most weekends and during at least three weeks of the summer vacation with family and friends. However, he will also allow people to lease or hire the yacht for a couple of weeks every year to help finance its purchase. He estimates that he will use the yacht for approximately 80% of the time for private purposes. As he is acting primarily outside his business, the rules regulating consumer contracts for sale will apply.

Illustration 2

B buys a laptop computer from a computer store. His purpose is to use the computer in his business as an engineering consultant. However, he will also use the computer for reading newspapers on the internet, his private e-mail, listening to music and watching films while commuting. He estimates that he will use the computer for approximately 20% of the time for private purposes. As he is not acting primarily outside his business, the rules regulating consumer contracts for sale will not apply.

Illustration 3

C buys tiles for the roof of her house, where 60% of the floor space is used for private purposes and 40% for business purposes (her law practice where she and her secretary spend most of their days). As she is acting primarily outside her business, the rules regulating consumer contracts for sale will apply.

A complicated question is whether the consumer definition contains or should contain a requirement that the consumer's purpose with regard to the transaction or act should be apparent to the professional as a requirement for the consumer protection rules to apply or if it is sufficient that the consumer had such a purpose concerning the transaction regardless of the knowledge of the professional. Under these rules the more consumer-friendly subjective approach is opted for in that the rules protecting consumers should be applicable regardless of whether the professional had knowledge of the consumer's purposes concerning the transaction. However, not explicitly addressing the question in the black-letter rule leaves room for the national courts and for the European Court of Justice to apply some flexibility depending upon the circumstances of the particular case.

As for the definition of the other party, "the business", it is evident from the definitions provided in the EC Directives that a "business" (or a "professional") could be a natural or legal person. It is appropriate to include also natural persons in the definition as long as they are acting for business purposes. One reason for this is that the way a person has chosen to organise the business should not be decisive when deciding whether or not the rules protecting the other party, i.e. the consumer, should be applicable. The important factor should therefore be whether the party is doing something on a more regular basis

and for the purpose of earning money. The transaction or act in which the natural or legal person participates could either be described positively, i.e. as being for business purposes, or negatively, e.g. as being not for personal, family or household purposes. For a standard definition, the positive approach is chosen as it is of some importance that the specific rules protecting the other party are applicable only when the person is in fact acting as a professional or business person and therefore knows or ought to have known that there are specific risks involved as the transaction is regulated by mandatory rules protecting the other party. Therefore, these rules should not apply in those borderline cases where the person is acting otherwise than for personal, family or household purposes, but not for business purposes.

In some cases, the natural or legal person could be acting both within and outside a trade, business or profession, i.e. the act or transaction could comprise elements or connecting factors from both spheres. As there is a risk that the consumer might believe that he or she is protected by mandatory consumer regulations when dealing with a person who at least to some extent is acting professionally in the field involved, the threshold should be rather low. Another reason for a relatively low threshold is that the consumer in these transactions is typically less informed than the other party. The main alternative here is therefore that the rules should be applicable as soon as the business or professional element is not negligible. It is for this reason that the word “primarily” is not used in the definition of a “business” as it is in the definition of a “consumer”.

Illustration 4

A, the seller, and B, a consumer, conclude a contract for the sale of a boat. A owns a business selling and manufacturing yachts. The boat sold is of the kind produced by A’s company and it is also situated at the company’s premises where it is inspected by B. The boat is however owned by A personally and he makes B aware of the fact that since he has financed the boat by private means he will therefore be named as the seller in the contract. However, the boat has been used inter alia for demonstration purposes at trade fairs. B also receives information concerning the boat printed on the company letterhead. In such a case it can be said that A is acting (to some extent) for purposes relating to his trade and the transaction is therefore a consumer contract for sale.

Moreover, a business seller should not be able to circumvent mandatory consumer protection rules by claiming that the goods are being sold on behalf of somebody else when, in reality, it is the business which bears the economic risk.

Finally, a profit motive is not essential for there to be a “business”. The definition says “even if the person does not intend to make a profit in the course of the activity”. A person may, for example, carry on a trade with the intention of breaking even while indulging an interest; or a person might carry on a trade with the intention of making a loss to offset against income for tax purposes. There would still be a “business” within the definition used here.

D. Protection of small businesses etc.

According to the European legislation the consumer should be a natural person. Since the beginning of the trend in rules giving consumers protection there have been arguments in favour of also protecting a wider category of persons. A major concern might in some cases be what should be done with small businesses, non-profit organisations and other legal persons which are in a weak position. In many respects they are in the same position as consumers as they usually do not have expertise concerning many issues. The difficulty is where to draw the line between legal persons worthy of protection and other legal persons. An attempt has been continually made to draw a precise line between these two categories. Should it be the number of employees that is decisive? The assets of the company? The turnover? The non-profit status of the legal entity? One or several of the mentioned criteria together with a description of the entity as a weaker party in the transaction in question? The problems seem to be insurmountable. At least, one could not find a formula which is applicable to all types of transactions or acts. Each possible solution will seem more or less arbitrary, where it is very difficult to provide convincing reasons for the substantive rules chosen. Therefore, these rules refrain from including special protection for small businesses and similar enterprises.

E. Consumer protection under the present rules

The present rules contain far-reaching protection for consumers.

First, some provisions apply exclusively to consumer contracts for sale: IV.A.–2:304 (Incorrect installation in a consumer contract for sale), IV.A.–2:308 (Relevant time for establishing conformity) paragraph (2), IV.A.–4:202 (Termination by consumer for lack of conformity), IV.A.–5:103 (Passing of risk in a consumer contract for sale) paragraph (1) and Chapter 6. These provisions provide the consumer with additional, more favourable rights than under the general regime.

Secondly, some provisions have been excluded for consumer purposes: IV.A.–4:301 (Examination of the goods), Chapter 5, Section 2 (excluded by IV.A.–5:103 (Passing of risk in a consumer contract for sale) paragraph (3)). These provisions are excluded as they are considered to be too harsh an obligation for the consumer or for being in conflict with a provision applying exclusively under consumer contracts for sale.

Thirdly, some rules are declared mandatory in consumer contracts for sale. For further information about mandatory rules under consumer contracts for sale and a list of the mandatory rules, cf. Comment B to the following Article.

Throughout these rules, the Comments to the relevant Articles will explain why and how the specific needs of the consumer-buyer have been taken into account.

F. Protection of parties other than consumer buyers

As pointed out in Comment A, the present rules deal only with a specific constellation of the parties acting in different capacities, i.e. the consumer contract for sale, by protecting

the consumer buyer vis-à-vis a professional seller. However, these rules, subject to one exception, do not contain any rules protecting non-professional sellers, i.e. ‘consumers’ selling goods (whether to a business or to another ‘consumer’). It cannot be overlooked that, while such a seller may have little knowledge of doing business, he or she still has to meet the same standards as a professional seller, which are often tailored to the requirements of trade and commerce.

Since this general regime is therefore rather commercially oriented and, thus, may be harsh on the seller, it has been considered necessary to protect the non-professional seller from a possibly high level of liability in the case of damages (see IV.A.–4:203: Limitation of liability for damages for non-business sellers). Conversely, business sellers are considered to take this risk as part-and-parcel of their trade or profession.

Section 3: Derogation

IV.A.–1:301: Rules not mandatory unless otherwise stated

The parties may exclude the application of any of the rules in this Part of Book IV or derogate from or vary their effects, except as otherwise provided in this Part.

COMMENTS

A. General

The basic rule contained in this Article is that the provisions in this Part of Book IV are default rules. Therefore the parties are, in principle, free to exclude, amend, modify, or otherwise derogate from them.

However, this freedom of contract rule is subject to an important restriction: if a given rule, or set of rules, is declared mandatory, the parties cannot derogate from it. The rules in this Part have made use of this restriction exclusively for the protection of consumers (see Comment B below). The parties may also be bound by more general mandatory rules in Books I to III (cf. under Comment E). And some rules, such as rules on scope and definition, are of their nature mandatory in effect although not expressly declared to be so.

B. Derogation in a consumer contract for sale

The most important consequence of the dichotomy between consumer and non-consumer contracts for sale concerns the status, or nature, of the rules contained in the present rules. While there is no general rule declaring consumer-specific provisions mandatory as such, there are several provisions that ensure a certain minimum level of protection. There are two different approaches in this respect. Firstly, two specific derogation provisions, IV.A.–3:209 and IV.A.–4:102 (Limits on derogation from remedies for non-conformity in a consumer contract for sale), declare the seller’s obligation with regard to conformity

and the remedies for non-performance of it to be mandatory in consumer contracts for sale. In other cases it is indicated directly in the specific article that it is mandatory in consumer contracts for sale: IV.A.–5:103 (Passing of risk in a consumer contract for sale) and several provisions in Chapter 6 (Consumer guarantees).

Under the specific derogation provisions, any contractual term or agreement concluded with the seller, before a lack of conformity is brought to the seller's attention, which directly or indirectly waives or restricts the buyer's rights is not binding on the consumer: IV.A.–2:309 (Limits on derogation from conformity rights in a consumer contract for sale) and IV.A.–4:104 (Limits on derogation from remedies for non-conformity in a consumer contract for sale). This means that the parties are only free to deviate from the relevant provisions after the buyer has notified the seller of the lack of conformity. It is not possible to deviate in advance from the regime provided in these rules, unless the buyer is granted more far-reaching rights than provided in the relevant articles. It has to be noted that the mandatory rules of the present rules are merely relatively mandatory, i.e. the parties are still free to derogate from them to the benefit of the buyer. It is not sufficient that the buyer is granted more protection in an overall view: that is extending some rights, while limiting others.

Under other Articles, such as IV.A.–5:103 (Passing of risk in a consumer contract for sale), IV.A.–6:103 (Guarantee document), IV.A.–6:107 (Burden of proof) and IV.A.–6:108 (Prolongation of the guarantee period), the parties may not, to the detriment of the consumer, exclude the application of the Article or derogate from or vary its effects. This is a limitation which leads to similar results as the one provided in the general limitation clauses. Under IV.A.–6:102 (Binding nature of the guarantee) certain formal requirements restricting the validity of the guarantee are not binding on the consumer. Under some Articles in Chapter 6, on the other hand, it is made clear that an exclusion or limitation of the scope of the guarantee in certain respects is possible but has to be clearly set out in the guarantee document in order to be effective, cf. IV.A.–6:105 (Guarantee limited to specific parts) and IV.A.–6:106 (Exclusion or limitation of the guarantor's liability). In addition, the comments to the relevant Articles will provide examples of their scope.

C. Direct and indirect derogation

This Article covers both direct and indirect derogation from the present rules. Cases of direct derogation will include excluding a given rule in the sales contract or in standard terms. Cases of indirect derogation will include providing a lesser right than the one provided for in the relevant rule or otherwise varying the rule to the detriment of the consumer. It is important to remember that even terms which do not exclude the application of a mandatory rule, or derogate from or vary its effects may amount to unfair contract terms and, for that reason may not be binding on the consumer (see Book II, Chapter 9, Section 4).

D. Violation of mandatory provisions

A term of a contract for sale which purports to derogate from a mandatory rule to the detriment of the consumer, for example by contracting out of such a provision, will be void – that is, automatically of no effect from the beginning (see the definition of “void” in Annex 1). As a consequence, the consumer is provided with the right laid down in the relevant provision, the protection of which the seller tried to circumvent.

E. Relationship with Books I to III

The idea of freedom of contract in general is a fundamental one in these model rules and is provided for, in general terms, in II.–1:102 (Party autonomy). The basic rule of freedom of contract is, however, subject to the rules on good faith and fair dealing and other mandatory rules. There is therefore no conflict between that general rule in Book II and the approach taken in this Part of Book IV.

CHAPTER 2: OBLIGATIONS OF THE SELLER

Section 1: Overview

IV.A.–2:101: Overview of obligations of the seller

The seller must:

- (a) transfer the ownership of the goods;*
- (b) deliver the goods;*
- (c) transfer such documents representing or relating to the goods as may be required by the contract; and*
- (d) ensure that the goods conform to the contract.*

COMMENTS

A. Main obligations of the seller

This Article provides an overview of the main obligations which the seller assumes under a sales contract, some of which are elaborated in the following Sections of this Chapter. This short list is not meant to be a chronological account of the performance of the obligations under a contract for sale.

However, it follows from IV.A.–1:301 (Rules not mandatory unless otherwise stated) that the parties are free to regulate the content of their obligations. Therefore the seller may not, on the one hand, be subject to all the obligations set out in this Article. The seller may not, for instance, be under an obligation to deliver the goods, as they are already in the buyer’s possession. On the other hand, the seller may also have to comply with a number of other obligations arising from the particular agreement between the parties

(e.g. an obligation to provide training in the use of the machinery delivered), from commercial usage or from other provisions contained in the present rules.

B. Obligation to transfer ownership

The obligation to transfer ownership is essential to the very notion of a sales contract; if the parties contract out of this obligation, their contract can generally not be considered to be a contract for the sale of goods.

The issue of when the transfer of ownership will take place, and what separate steps, if any, must be taken to effect the transfer are addressed in Book VIII on the Acquisition and Loss of Ownership in Movables. The present rules only deal with obligational issues. They require the seller to transfer ownership of the goods either immediately upon the conclusion of the contract or at some future time (see above IV.A.–1:202 (Contract for sale)).

It may be possible that the seller has to transfer ownership to a person other than the opposing party in the sales contract, as is also reflected in the definition in IV.A.–1:202 (Contract for sale).

Illustration 1

A, situated in the Netherlands, orders flowers from Fleurop to be delivered to his girlfriend, currently working in Poland. Here, the flower seller has to deliver the flowers to a third party, who will also become the owner of the goods.

C. Obligation to deliver the goods

The seller is typically under an obligation to deliver the goods to the buyer. This important obligation is spelled out in greater detail in IV.A.–2:201 (Delivery), which also makes it clear that the seller may have to deliver the goods to a party other than the buyer.

However, there are cases where the seller may not have to deliver the goods at all, as the goods are already in the buyer's possession or they are to remain in the seller's possession. In these cases, the obligation to deliver under IV.A.–2:201 (Delivery) does not apply either (as it has been expressly or impliedly derogated from), or it is an obligation that is immediately performed (for example, the seller is treated as having delivered the goods which are still in the seller's possession but are held for the buyer).

Illustration 2

A has borrowed machinery for planting trees from his neighbour B. After the expiry of the period of use, A wants to buy the machine from B. The parties agree on a price, which A pays in cash.

Illustration 3

A agrees to sell her student books to B, who will come to the university to take the same course next year. Since B does not yet have a place to live while A has rented her room over the summer, they agree that A will store the books until the start of the new academic year.

It should be noted that the details of such a constructive delivery for the transfer of ownership are also left to Book VIII on the Acquisition and Loss of Ownership in Movables (e.g. the requirements for either the *traditio brevi manu* or the *constitutum possessorium*, or the question of what constitutes possession).

D. Obligation to transfer documents

The contract may require the seller to transfer documents representing or relating to the goods. Documents representing the goods serve an important purpose, as the seller can sometimes actually perform the obligation to deliver the goods by merely transferring the documents representing them (see IV.A.–2:201 (Delivery) paragraph (1)). The seller may also be under an obligation to deliver the goods to a carrier and then deliver the shipping documents to the buyer. If the goods are already in transit when they are sold, the seller's only delivery obligation may be to deliver the documents to the buyer (a 'documentary sale'). Documents relating to the goods may for instance be documents primarily relating to the use and proper function of the goods, which are significant for the performance of the sale.

Given the rapid changes on the documents market, the present rules do not provide a list of relevant documents. However, all kinds of documents may be covered, such as bills of lading, insurance policies, export licences, receipts of payment of customs duties, manuals, certificates, instructions, trade descriptions or reviews. The transfer of documents encompasses more than just the handing over of the relevant documents. The seller may, for instance, also send them by electronic means or by fax. The seller's obligation may include taking steps to ensure the validity of the documents representing the goods, e.g. signatures, endorsements and other formalities.

Even if nothing has been expressly agreed, under IV.A.–2:302 (Fitness for purpose, qualities, packaging) sub-paragraph (e) the seller may have to transfer certain documents relating to the goods, such as installation or other instructions.

E. Obligation to ensure conformity with the contract

Section 3 of the present Chapter elaborates the seller's obligation to deliver goods which conform to the contract in every way. It should be pointed out, however, that the reference in (c) under this Article does not refer only to IV.A.–2:301 (Conformity with the contract), but also to the further provisions in Section 3 addressing various other aspects of conformity, such as IV.A.–2:202 (Fitness for purpose, qualities, packaging), IV.A.–2:304 (Incorrect installation in a consumer contract for sale) and IV.A.–2:305 (Third party rights or claims in general).

In this context, it is therefore important to note that the present rules start from a wide notion of conformity, which may give rise to the remedies for lack of conformity in Chapter 4, Section 2.

F. Remedies for the buyer

If the seller fails to perform any of the obligations under the contract, the buyer is entitled to the remedies set out in Book III, Chapter 3, as slightly modified by Chapter 4 of the present rules.

G. Relationship with Book II

Book II contains rules addressing the contents and effects of contracts in Chapter 9, and these may clarify what becomes part of a contract. Thus, they may also influence the seller's obligations under the contract. In particular, regard must be had to II.-9:101 (Terms of a contract), II.-9:102 (Certain pre-contractual statements regarded as contract terms), and II.-9:108 (Quality). However, the rules in this Chapter can be considered as more sales-specific applications of the general Articles just mentioned.

Section 2: Delivery of the goods

IV.A.-2:201: Delivery

(1) The seller fulfils the obligation to deliver by making the goods, or where it is agreed that the seller need only deliver documents representing the goods, the documents, available to the buyer.

(2) If the contract involves carriage of the goods by a carrier or series of carriers, the seller fulfils the obligation to deliver by handing over the goods to the first carrier for transmission to the buyer and by transferring to the buyer any document necessary to enable the buyer to take over the goods from the carrier holding the goods.

(3) In this Article, any reference to the buyer includes a third person to whom delivery is to be made in accordance with the contract.

COMMENTS

A. General

This Article elaborates the seller's obligation to deliver the goods, which is typical of a sales contract (but see IV.A.-2:101 Comment C for cases where the seller may actually not need to deliver the goods at all). Unless agreed otherwise, the main principle is that the seller is obliged to make the goods available to the buyer. If the parties' agreement involves documents representing the goods, the same principle applies to those

documents. Paragraph (2) addresses the important case in which the goods are to be sent by a carrier to the buyer.

The point in time for delivery is important in many respects. In many cases, the risk concerning the goods will pass at the same time. This is for instance the case where carriage is involved, cf. paragraphs (2) and (4) of this Article and IV.A.–5:202 (Carriage of the goods) paragraph (3). Moreover, the requirement to examine the goods under IV.A.–4:301 (Examination of the goods) will mostly arise upon delivery.

B. Functional definition of delivery

Paragraph (1) provides a functional definition of the seller's obligation to deliver, the purpose being that the seller must make the goods, or documents representing them, available to the buyer. While this will normally result in the transfer of physical control over the goods, there may be cases where the transfer of physical control does not apply, for instance because such a transfer, though possible, has not been envisaged by the parties, since the goods are to remain with the seller or because the nature of the goods renders such a transfer impossible. (This latter case will however normally mainly apply to immovable property). In such cases, the seller can make the goods available to the buyer in other ways (see also Comment C).

Illustration 1

A sells a horse to B. The parties agree that the horse is to remain in A's stable, since B has no stable, and that B will pay for A's care of the horse each month.

At the same time, this broad functional definition of delivery ('making available') also makes sure that the seller can deliver assets other than goods, which fall under the scope of the present rules by virtue of IV.A.–1:101 (Contracts covered) paragraph (2). This applies especially to incorporeal property, such as certain rights.

C. Different modes of delivery

As pointed out in Comment B, the functional definition of delivery in paragraph (1) allows for different ways to comply with the obligation to deliver the goods. Above all, it is the contract that ultimately answers the question of how the seller has to deliver the goods. The seller may, for instance, be required to deliver in a certain way; likewise, the contract may give the seller different options for delivery.

While it is therefore virtually impossible to spell out all possible variants in the rule on delivery, it may help to provide a few examples of different methods of delivery.

The seller may deliver the goods by transferring physical control to the buyer. Unless the parties have agreed otherwise, the buyer has to pick up the goods at the seller's place of business or residence (see IV.A.–2:202 (Place and time for delivery) Comment B) and the seller's obligation will be to make them available there. The seller can also hand over keys to the goods, for instance car keys or the keys to a warehouse where the goods are

located. This variant also covers other means to allow the buyer to take control of the goods, e.g. the seller can provide the buyer with an access code to the goods. However, the parties may also have agreed that the seller is to transport the goods to the buyer (cf. illustration 4); in such a case the seller will make the goods available by delivering the goods to the buyer at the buyer's residence or place of business.

It is also possible for the seller to deliver without the transfer of immediate physical control to the buyer. This is the case where the seller is to make the goods available at a place other than the seller's place of business (cf. also IV.A.–5:201 (Goods placed at buyer's disposal) paragraph (2)). The parties can agree that the seller has to make the goods ready for collection by the buyer at a designated place, at which the seller will have left them.

Illustration 2

A, a retailer, sells goods to B. They agree that the goods will be made available to B at a certain date directly at the place of production, a factory, which is close to B's place of business. A has fulfilled the obligation to deliver as soon as the goods are made available to the buyer at the agreed place.

Thirdly, as envisaged in paragraph (1), the seller can fulfil the obligation to deliver by transferring documents representing the goods to the buyer.

Illustration 3

A and B conclude a contract for goods that are already in transit. The seller performs the obligation to deliver by handing over the bill of lading to the buyer.

Since these documents embody the goods, their transfer is sufficient to deliver the goods as such. As a result, the buyer, while not having received the goods as yet, obtains the necessary means to demand the goods from the person who is in possession of them. This mode of delivery plays an important role when the goods are subject to carriage (see Comment D below). The seller can also take other measures to enable the buyer to obtain the goods from a third person, for instance by instructing this person to release the goods (e.g. by e-mail, fax, telephone). In the context of delivery by means of documents, it should be noted that only documents representing the goods are of relevance.

D. Carriage of goods

This Article provides for a specific rule on delivery if the parties agree that the goods are to be carried from the seller to the buyer by a third party carrier. According to paragraph (2), the seller delivers by handing over the goods to the carrier, and by transferring to the buyer any document necessary to take over the goods from the carrier. This method of delivery reflects the important role that documents play in international commercial sales transactions, which frequently involve the carriage of goods.

Where the goods are to be carried by a series of carriers the seller fulfils the obligation to deliver by handing the goods over to the first carrier for transmission to the buyer and by transferring the relevant documents to the buyer. Those documents should enable the buyer to take over the goods from the carrier holding the goods.

It should be noted that the rule on delivery in the case of carriage only applies if an independent carrier transports the goods. Therefore it does not cover cases where the seller's or the buyer's own employees undertake the carriage of the goods.

Illustration 4

A and B conclude a contract for the sale of building materials. The parties agree that the materials will be directly transported to B's building site. Transportation is organised by one of A's employees. The seller is deemed to have fulfilled the obligation to deliver only when the goods are handed over to B or one of B's employees at the building site.

Finally, it should be pointed out that the parties may naturally agree that the seller's obligation to deliver is fulfilled at a later point in time even if a carrier is involved.

E. Delivery to persons other than the buyer

This Article starts from the assumption that the seller has to deliver the goods to the buyer. However, the parties are free to agree otherwise as is made clear in paragraph (3). It may be possible that the goods are either not destined for the buyer at all, for instance if the buyer has bought raw materials for a subsidiary, or are not to be directly delivered to the buyer, for instance in the case of an interim storage at a warehouse.

In such a case, the rules in this Article apply to the other person as if that person were the buyer. Therefore the seller complies with the obligation to deliver the goods by making them available to the person indicated in the contract.

F. Consumer contract for sale

This Article is only of a default nature and does not contain any special consumer protective elements. However, it should be kept in mind that under a consumer contract for sale, the risk passes only upon handing over the goods to the buyer in the event of carriage (see IV.A.-5:103 (Passing of risk in a consumer contract for sale) Comment C).

IV.A.-2:202: Place and time for delivery

(1) The place and time for delivery are determined by III.-2:101 (Place of performance) and III.-2:102 (Time of performance) as modified by this Article.

(2) If the performance of the obligation to deliver requires the transfer of documents representing the goods, the seller must transfer them at such a time and place and in such a form as is required by the contract.

(3) If in a consumer contract for sale the contract involves carriage of goods by a carrier or a series of carriers and the consumer is given a time for delivery, the goods must be received from the last carrier or made available for collection from that carrier by that time.

COMMENTS

A. General

The seller performs the obligation to deliver only if delivery is made at the right place and time. In the absence of an agreement between the parties, the general rules on performance in III.–2:101 (Place of performance) and III.–2:102 (Time of performance) apply. However, paragraph (2) introduces a special rule for the transfer of documents representing the goods.

B. Place and time for delivery

According to III.–2:101 (Place of performance), the seller has to deliver at the place fixed by or determinable from the sales contract. If the contract remains silent on this point, the seller has to deliver at the seller's place of business or, in the absence of such a place, at the seller's habitual residence. Thus, the default rule on the place for delivery is that the buyer has to pick up the goods from the seller's place of business or residence.

According to III.–2:102 (Time of performance), the seller has to deliver at the time, or within the period, fixed by or determinable from the sales contract. In the absence of such an agreement, the seller has to deliver within a reasonable time after the conclusion of the sales contract.

C. Transfer of documents representing the goods

The seller may sometimes be able to effect delivery by transferring documents representing the goods, see IV.A.–2:201 (Delivery) paragraph (1). In such a case, the seller must transfer such documents at the place and time and in the form required by the contract. This rule is so framed as to cover the transfer of documents to parties other than the buyer (cf. IV.A.–2:201 (Delivery) paragraph (3)).

D. Remedies of the buyer in the event of late delivery

If the seller is late in delivering, the buyer may resort to the remedies set out in Book III, Chapter 3. Conversely, if the seller delivers too early, the buyer may take or refuse delivery in accordance with IV.A.–3:302 (Early delivery and delivery of excess quantity) paragraph (1).

IV.A.–2:203: Cure in case of early delivery

(1) If the seller has delivered goods before the time for delivery, the seller may, up to that time, deliver any missing part or make up any deficiency in the quantity of the goods

delivered, or deliver goods in replacement of any non-conforming goods delivered or otherwise remedy any lack of conformity in the goods delivered, provided that the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense.

(2) If the seller has transferred documents before the time required by the contract, the seller may, up to that time, cure any lack of conformity in the documents, provided that the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense.

(3) This Article does not preclude the buyer from claiming damages, in accordance with Book III, Chapter 3, Section 7 (Damages and interest), for any loss not remedied by the seller's cure.

COMMENTS

A. General

In the case of early delivery, this Article allows the seller a qualified right to rectify any lack of conformity, be it in the goods or in the documents, up until the due date for delivery. It is important to note that this right to cure does not allow the seller to deliver the goods earlier than agreed. Instead, if the seller tenders delivery before the due date (i.e. the original date for delivery agreed between the parties) the buyer has a right to either refuse or accept delivery under IV.A.–3:302 (Early delivery and delivery of excess quantity) paragraph (1). The present cure provision applies only if the buyer has accepted the goods.

The rationale behind this rule is that the seller is not yet in breach of the obligation. This follows from the presumption that the seller is only obliged to ensure that the goods are in conformity from the point in time when the performance is actually due. The seller may therefore remedy any shortcoming in the goods up until the due date for delivery, which, technically speaking, cannot yet be considered as a lack of conformity. The buyer's interests are protected in two ways. On the one hand, the buyer does not, as a rule, have to accept early delivery by the seller. The seller, on the other hand, is limited in the right to rectify any lack of conformity, since doing so must not cause unreasonable inconvenience or expense to the buyer. Finally, it should be noted that, in practice, it will be rather rare for the seller to deliver early. The impact of this rule is therefore likely to remain limited.

B. The seller's right to cure before the time for delivery

By and large, the seller may cure any shortcoming in the early delivery, provided that doing so does not cause the buyer unreasonable inconvenience or expense (for this condition, see Comment C). The different possibilities for rectification in this Article correspond to the buyer's remedies for a lack of conformity.

In addition, paragraph (2) enables the seller to rectify any lack of conformity in the documents up until the time agreed in the contract.

C. Unreasonable inconvenience or expense

The seller may exercise the right to rectify under this Article only if this does not cause the buyer unreasonable inconvenience or unreasonable expense, for instance by delivering the missing parts bit by bit or by interrupting the buyer's business by sending a technician to repair a machine that does not conform, but is still working at a time when the buyer needs to use the machine.

In order to establish what amounts to unreasonable inconvenience or expense, regard is to be had to the definition of "reasonable" in Annex 1.

What is "reasonable" is to be objectively ascertained, having regard to the nature and purpose of what is being done, to the circumstances of the case and to any relevant usages and practices.

Accordingly, the circumstances of the case will have to be considered in deciding the standards of unreasonableness. Apart from pure economic qualifications, also criteria such as time, transportation, logistics and storage have to be taken into account.

D. Buyer's remedies

The seller has not yet failed to perform the obligation to ensure that the goods are in conformity with the contract in the case of early delivery. Thus, the buyer cannot exercise rights in respect of lack of conformity under Chapter 4 until the due date for delivery. The buyer may, however, refuse to take delivery altogether according to IV.A.–3:302 (Early delivery and delivery of excess quantity) paragraph (1).

However, under paragraph (3) the buyer is not precluded from claiming damages for any loss not remedied by the seller's rectification. Such loss might include inconvenience or expense which are not sufficient to bar the seller's right to cure.

E. Relationship with Book III

Book III, Chapter 3, Section 2 contains provisions on cure by the debtor of a non-conforming performance. One of those provisions is that "The debtor may make a new and conforming tender if that can be done within the time allowed for performance" (III.–3:202 (Cure by debtor: general rules) paragraph (1).

The reason behind the present Article is that III.–3:202 (1) does not address cases where the buyer has actually accepted the goods tendered by the seller, which may well turn out not to be in conformity with the contract. The present Article has to be read in the context of IV.A.–3:302 (Early delivery and delivery of excess quantity) paragraph (1), which gives the buyer the opportunity to either reject or accept the goods. If the buyer chooses to accept the goods, the seller has several possibilities to cure a lack of conformity in the

goods. By making sure that the seller may only exercise the rights if they do not cause the buyer unreasonable inconvenience or expense, the buyer's interests are taken into account. In contrast, the rule in III.-3:202 (Cure by debtor: general rules) paragraph (1) still applies if the buyer has not accepted the goods, which the buyer is entitled to do according to IV.A.-3:302 (Early delivery and delivery of excess quantity) paragraph (1).

IV.A.-2:204: Carriage of the goods

(1) If the contract requires the seller to arrange for carriage of the goods, the seller must make such contracts as are necessary for carriage to the place fixed by means of transportation appropriate in the circumstances and according to the usual terms for such transportation.

(2) If the seller, in accordance with the contract, hands over the goods to a carrier and if the goods are not clearly identified to the contract by markings on the goods, by shipping documents or otherwise, the seller must give the buyer notice of the consignment specifying the goods.

(3) If the contract does not require the seller to effect insurance in respect of the carriage of the goods, the seller must, at the buyer's request, provide the buyer with all available information necessary to enable the buyer to effect such insurance.

COMMENTS

A. General

This Article sets out various obligations on the part of the seller where the goods are to be carried from the seller to the buyer (or to another agreed person) by a third party carrier. It is important to note that it does not answer the question of who has to arrange for the carriage of the goods, which ultimately depends on the agreement between the parties.

The notion of carriage of goods does not cover cases where the seller's or buyer's own employees undertake to transport the goods to the buyer (cf. IV.A.-5:202 (Carriage of the goods) Comment C).

B. Seller's obligations in the case of carriage

If the parties have agreed on the carriage of the goods, the seller has to undertake a number of obligations or duties in addition to the obligation to deliver, which already requires the seller to hand over the goods to the carrier and to transfer to the buyer any documents representing the goods. Accordingly, the seller has to:

- i) make the necessary and appropriate contracts for the carriage of the goods, if obliged to arrange for carriage (paragraph (1));

- ii) issue and provide the buyer with a notice of consignment for the dispatch of goods that are not clearly identified to the contract (paragraph (2)); and
- iii) allow the buyer, upon request, to take out insurance for the goods unless the seller is to insure the goods (paragraph (3)).

While these obligations of the seller mostly concern international commercial sales involving cross-border carriage, they may also apply to other transactions where the parties agree that the seller is bound to arrange for carriage.

C. Remedies of the buyer

If the seller fails to fulfil the obligations set out in this Article the buyer may resort to the normal remedies contained in Book III.

In the case of paragraph (2), the buyer also benefits from IV.A.–5:102 (Time when risk passes) paragraph (2), as risk does not pass before the goods are duly identified to the contract.

D. Consumer contract for sale

It should be noted that under IV.A.–5:103 (Passing of risk in a consumer contract for sale) paragraph (1) the general rule under a consumer contract for sale is that the risk does not pass to the consumer until the goods are actually taken over. This means that the goods will travel at the risk of the seller. Hence, paragraph (3) of this Article will be of limited importance in consumer contracts for sale since it will generally be in the seller's interest to arrange for insurance, since any loss of or damage to the goods before they reach the consumer will be the seller's responsibility.

Section 3: Conformity of the goods

IV.A.–2:301: Conformity with the contract

The goods do not conform with the contract unless they:

- (a) are of the quantity, quality and description required by the contract;*
- (b) are contained or packaged in the manner required by the contract;*
- (c) are supplied along with any accessories, installation instructions or other instructions required by the contract; and*
- (d) comply with the remaining Articles of this Section.*

COMMENTS

A. General

One of the most important obligations in sales law is that the seller has to ensure that the goods sold are in conformity with the contract (see IV.A.–2:101 (Overview of obligations

of the seller)). This Section elaborates the meaning of conformity. From the outset, it is important to note that this obligation is separate from the seller's obligation to deliver the goods. Most importantly, a non-performance of the seller's obligation to deliver (late delivery or no delivery at all) triggers the general remedies regime under Book III. However, a non-performance of the conformity obligation is followed by a separate remedies regime under Chapter 4 of this Part, which addresses particular problems linked to non-conforming goods.

Moreover, even if the seller may not have to deliver the goods at all, the obligation to ensure the conformity of the goods still applies.

Illustration 1

A has rented a TV set from B. B agrees that A can buy the set outright. If A exercises the right to buy, B's obligation to ensure that the goods conform to the contract applies even though the TV set does not have to be physically delivered to A because A already has it.

B. Agreed conformity: the obligation to ensure that the goods are in conformity with the contract

Above all, this Article emphasises the significance of the parties' agreement by referring to what is "required by the contract". Sub-paragraphs (a) to (c) spell out different features of conformity, which make it clear that the goods must be of the right quantity, quality and, description; must be contained or packaged in the right way; and must be supplied along with possible accessories and instructions.

Finally, sub-paragraph (d) contains an important reference to the remaining Articles of this Section, which makes it clear that the central provision of the present Article is complemented by further provisions addressing various other aspects of conformity, such as IV.A.–2:302 (Fitness for purpose, qualities, packaging), IV.A.–2:304 (Incorrect installation in a consumer contract for sale) and IV.A.–2:305 (Third party rights or claims in general).

C. Quantity, quality and description

Under (a) the seller has to ensure that the goods are of the quantity, quality and description required by the contract. The first aspect of conformity mentioned here, i.e. that of quantity, covers two different scenarios.

First, the seller may deliver less than was agreed upon, e.g. only 400 tyres instead of 500. This shortcoming is qualified as a lack of conformity. Consequently, the buyer may exercise the remedies contained in Chapter 4, Section 2. However, this does not apply if the seller fails to deliver any goods at all. Such non-performance (which may be late performance or delay, or total non-performance) is considered to be a non-performance of the obligation to deliver the goods and follows a different remedial regime (see IV.A.–4:101 (Application of Book III) Comment C).

Illustration 2

A agrees to sell 500 edible snails, packed in boxes, to B, but delivers only 400. The rules on lack of conformity apply. This case is a clear example of the rationale behind the concise nature of the notion of conformity. It does not make a difference in the applicable regime whether A delivers 500 snails, of which 100 are of the wrong quality, or 500 of the wrong quality.

Secondly, the seller may deliver more than was agreed upon, e.g. 550 tyres instead of 500. IV.A.–3:302 (Early delivery and delivery of excess quantity) addresses this special case by setting out the buyer's rights: if the seller delivers an excess quantity the buyer can either refuse to take, or take, delivery of the amount exceeding the quantity agreed upon. In the latter case, the buyer has to pay for the excess amount.

D. Conformity includes incidental matters

As shown by (b) and (c), the notion of conformity includes certain incidental aspects of the goods. The core goods may be flawless in their own right, while something else renders them not in conformity with the contract. The parties may, for instance, have agreed to package the goods in a special way, to deliver instruction manuals or to supply a repair kit with a car. A seller who fails to perform such obligations has failed to deliver goods conforming to the contract.

Such additional, extraneous features of conformity pose no problem under the present Article, since the parties have agreed on them. They are required by the contract. While these cases could arguably be solved by relying on the description of the goods under (a), for instance that selling a car includes a spare tyre and a repair kit, the express mention is designed to raise awareness of what the seller may also have to supply in addition to the core goods themselves.

However, these extraneous features of conformity play an important role under IV.A.–2:302 (Fitness for purpose, qualities, packaging). This idea of extending conformity beyond the core goods as such has even been carried further by IV.A.–2:204 (Incorrect installation in a consumer contract for sale) for consumer transactions, as the seller can also be held responsible for the incorrect installation of otherwise flawless goods.

E. The aliud

Some legal systems differentiate between defective goods and goods that are something completely different from what the parties had agreed upon, the so-called aliud. The present rules reject this idea. As a result, the notion of conformity applies to all goods, regardless of whether they may deviate substantially from what was agreed upon. If entirely different goods are supplied the buyer can still resort to the remedies for lack of conformity set out in Chapter 4 Section 2.

Illustration 3

A and B conclude a sale concerning red wine from a certain area in Italy. A delivers (a) white wine, (b) red wine from Spain and (c) red wine vinegar. All these deliveries deviate from the contract; arguably they constitute an altogether different performance. Instead of attempting to resolve the question of what can still be seen as a defective performance, and what is an aliud, these cases fall – beyond doubt – under the heading of lack of conformity

F. Remedies of the buyer

If the seller does not perform the obligation under this Article, the buyer can resort to the remedies set out in Chapter 4, Section 2 (subject, in some cases, to certain requirements such as examination and notification).

IV.A.–2:302: Fitness for purpose, qualities, packaging

The goods must:

- (a) be fit for any particular purpose made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for the buyer to rely, on the seller's skill and judgement;*
- (b) be fit for the purposes for which goods of the same description would ordinarily be used;*
- (c) possess the qualities of goods which the seller held out to the buyer as a sample or model;*
- (d) be contained or packaged in the manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods;*
- (e) be supplied along with such accessories, installation instructions or other instructions as the buyer may reasonably expect to receive; and*
- (f) possess such qualities and performance capabilities as the buyer may reasonably expect.*

COMMENTS

A. General

This Article, together with IV.A.–2:303 (Statements by third persons), ensures that unless the parties have agreed otherwise, the goods have to live up to certain standards and expectations. The obligations under this article reflect what the buyer will normally expect.

The Article lays down various criteria for establishing conformity, and hence a lack of conformity. These criteria are default rules, as the parties are free to agree upon different standards in their contract. Nonetheless, they serve an important purpose by clarifying what conformity normally entails ('The goods must'). In fact, this wording seems slightly more straightforward than that of either the CISG, which stipulates when the goods do not conform to the contract ('goods do not conform [...] unless'), or the CSD, which sets

out presumptions of conformity ('goods are presumed to be in conformity [...] if they'). Notwithstanding these differences in drafting, the result remains the same in so far as the goods, unless the contract provides otherwise, are supposed to live up to certain standards and expectations, i.e. the minimum requirements laid down in sub-paragraphs (a) to (f).

The Article gives an indication as to what the notion of conformity entails, and, by doing so, can clarify vague statements, such as references to general quality standards. Conversely, if the seller wants to exclude the application of one of the requirements in (a) to (f), this will have to be addressed in the sales contract (see Illustration 2 below). In this way, even though the parties are free to agree on a different standard of conformity, these implied requirements may therefore influence the application of IV.A.-2:301 (Conformity with the contract).

A particularly important factor is how the goods have been described. The buyer is entitled to goods that will, for instance, be fit for the purposes for which goods of that description are ordinarily used. Thus goods sold as food for people must normally be at least fit for human consumption, shoes must be fit for wearing and motor cars must be roadworthy. But if the seller's description of what is offered for sale makes it clear that the goods are sub-standard, then the goods only have to be fit for the purpose for which such sub-standard goods would commonly be used.

Illustration 1

A car dealer offers a used car for sale to a private motorist. The car has been involved in an accident and there is a major problem with the chassis which results in the car being unsafe. The car is not fit for the purpose for which cars are normally used and does not conform to the contract.

Illustration 2

The seller sells the car as a 'write-off' and 'for parts only'. The defect in the chassis does not prevent the car conforming to the contract, since it was described as not fit to drive.

In a non-consumer case the parties are in any event free to derogate from these rules. Thus the seller of the written-off car could in principle achieve the same result simply by excluding the application of IV.A.-2:302 (b) – although that would be a less transparent way of proceeding and would run more risk of a challenge under Book II, Chapter 9, Section 4. Even where the seller uses a description such as "scrap car, for parts only", the goods must still be fit for the purposes for which goods of that description would normally be used. Thus if the dealer sells what is described as a 'written-off 2003 Peugeot, for parts only' and in fact the original parts that are useable have already been stripped out and replaced by worn-out parts taken from other cars, the goods are not in conformity with the contract. They are not fit for use in the way described as a source of parts.

It will be seen that the same principles apply to the other aspects of conformity. Thus if the seller shows the buyer a sample of, say, a computer that is for sale in a sealed box, and the computer shown is in perfect working order, then the actual computer supplied must be of the same standard. If, in contrast, the seller shows the buyer an obviously dysfunctional computer, the goods supplied need not be any better. (If the seller shows the buyer a new computer but says that the one supplied will not be in the same condition, the first computer is not being held out as a sample.)

This holds equally true for consumer contracts for sale, albeit with an important caveat in IV.A.–2:309 (Limits on derogation from conformity rights in a consumer contract for sale). In a consumer contract for sale the rights given by this Article cannot be excluded or restricted. This does not mean that a seller cannot sell a written-off car to a consumer without incurring liability for non-conformity. What it does mean is that the seller must ensure that the car is described as just what it is - a 'write-off, good for parts only' - rather than relying on some clause which the consumer may not read or may not understand. For the question of a derogation from these implied requirements under consumer contracts for sale, see further IV.A.–2:309 (Limits on derogation from conformity rights in a consumer contract for sale) Comment B.

B. Default requirements of conformity

The different requirements of this Article constitute default rules; therefore the parties are in principle free to agree to modify or exclude, or otherwise to deviate from them. One can distinguish six basic aspects of conformity, which apply in a cumulative manner:

Fitness for purpose. The fitness for purpose issue is dealt with in (a) and (b). To start with the more general statement, the goods sold have to be fit for their ordinary purposes, i.e. the ones for which goods of that description are commonly used. Moreover, the goods may also have to be fit for a certain particular purpose, such as an uncommon application or use of goods. However, in such a case the seller is liable only if two conditions are met. First, the buyer must have made the particular purpose known when concluding the contract. Secondly, the buyer must have relied on the seller's expertise and it must have been reasonable to do so.

Illustration 3

A buys a notebook computer from B. If it fails to perform its normal task, that is work in an office environment, it is not in conformity. If it will work in the office but A uses the notebook for an unusual application, e.g. his research in a rainforest, where it fails to work, B can only be held responsible if he made this particular purpose known to the seller. The seller can still escape liability if he can show that the buyer could not (reasonably) have relied on his skill and judgement, for instance as the notebook was sold in bulk in a supermarket.

Sample or model. Reference to a sample or model is regulated by (c) as a special instance of the seller's description. In essence, this rule relates to specific information given to the buyer before the conclusion of the contract. In other words, the buyer can

rely on the fact that the delivered goods will show the same qualities as the samples or models upon which the decision to purchase was made.

Packaging. The proper packaging for the goods is dealt with in (d). The seller has to package the goods in the manner usual for such goods, and if there is no such usual manner, has to package them in a way adequate to preserve and protect the goods. This distinction suggests that certain standards or usages in commerce prevail over the rationale of the rule, i.e. making sure that goods are not unnecessarily exposed to damage. Even though such a rule has an obvious application in commercial cases – as proper containment and packaging may prove essential for handling the goods – it may also play a role in other settings, such as consumer contracts for sale or transactions between private parties. The latter have become even more relevant with the increase in distance sales, especially those concluded via the Internet.

Accessories. The seller may have to deliver certain accessories, for instance a spare tyre and a repair kit together with a car. Obviously, these items could be sold separately, but should be covered by the conformity obligation if it is customary that they are included in the price and if the buyer can therefore reasonably expect them.

Instructions. Installation or other instructions are, according to (e), part of the conformity standard if the buyer can reasonably expect to receive them. Naturally, parties can agree to deliver goods with instructions; this obligation is then already governed by IV.A.–2:301 (Conformity with the contract) sub-paragraph (c). However, the rule in (e) takes into account the fact that certain goods are so complicated that the buyer may need instructions to use them. As a result, these instructions are considered to be part of the goods by way of implication. It depends on the circumstances whether the buyer can indeed expect instructions, but this would often be the case concerning technical equipment. In the case of brown or white goods, the consumer will expect instructions as to their use. Under sub-paragraph (e) there is no requirement as to the language or languages in which the instructions should be written. No practicable solution was found in order to safeguard that the buyer actually understands the instructions. Nevertheless, it can be required that the language has a link to either the buyer or the seller, the place where the sales contract was concluded or the language in which it was concluded.

Illustration 4

A consumer buys a sewing-machine in a normal shop in an EU Member State. When he arrives home he discovers that the instructions are only provided in Chinese. This is clearly not what he may reasonably expect and hence the buyer will be entitled to claim remedies for non-conformity.

Buyer's reasonable expectations. The general quality standard is regulated in (f), as the goods have to show certain qualities and performance capabilities, which depend on the buyer's expectations. This rule is very important as it emphasises the buyer's point of view by introducing the buyer's expectations as a separate, stand-alone implied requirement which the goods have to meet. Having said that, it should be noted that the

expectations on the part of the buyer are already implicit in the previous sub-paragraphs, but (f) functions as a general sweep-up rule, since it goes beyond what is already covered in the rest of the provision. However, it should be pointed out that not all subjective expectations of a buyer which are unknown to the seller should have an influence on the question of conformity, even if they are reasonable. In particular, there may be different opinions on what is reasonable with regard to performance capabilities: what may be regarded as excellent performance capacities in one country (shoes lasting only one year), may be seen as poor quality in another. Ultimately, what the buyer may reasonably expect under this paragraph will have to be decided by the Courts.

In evaluating the buyer's expectations, regard must be had to what one can expect from certain comparable goods (cf. the similar issue under Article 6 of the Product Liability Directive, which, *inter alia*, refers to 'the presentation of the goods' and 'the use to which it could reasonably be expected that the product would be put'). Some general examples may be where advertising creates expectations or where the goods are fit for their purpose but are not of a high enough general quality. More concretely, sub-paragraph (f) could be used, for instance, in relation to durability expectations for goods sold as sub-standard or for second-hand goods. Particularly under consumer contracts for sale, the buyer's reasonable expectations could also relate to after-sales services or the availability of spare parts. Also the expectations could concern the origin of a certain product.

Illustration 5

A buys a yacht from B. A has assumed that the boat has been produced in a certain country like all the previous ones of this type. However, it turns out that the keel was constructed in another country, a fact which gives the yacht a lower market value. The yacht is not in conformity with the contract since it does not live up to the buyer's reasonable expectations.

IV.A.-2:303: Statements by third persons

The goods must possess the qualities and performance capabilities held out in any statement on the specific characteristics of the goods made about them by a person in earlier links of the business chain, the producer or the producer's representative which forms part of the terms of the contract by virtue of II.-9:102 (Certain pre-contractual statements regarded as contract terms).

COMMENTS

A. General

This Article addresses the question of whether and to what extent the seller becomes bound by statements relating to the goods made by third persons. Such statements are very influential, as buyers may often trust more in advertisements and brand literature than in the expertise of a given retailer. On the one hand, this rule relates to the notion of agreed conformity of IV.A.-2:301 (Conformity with the contract), as it determines the

seller's contractual liability for statements made by others. On the other hand, it also deals with the buyer's expectations under IV.A.–2:302 (Fitness for purpose, qualities, packaging), in that statements by third parties may also give rise to expectations as to the qualities and performance capabilities of the goods. Thus, under IV.A.–2:302(f), such statements may also be taken into account when assessing the reasonable expectations of the buyer.

B. Relationship to Book II

The Article refers to II.–9:102 (Certain pre-contractual statements regarded as contract terms). It is included here as a reminder. Reference is made to the Comments on that Article.

IV.A.–2:304: Incorrect installation under a consumer contract for sale

Where goods supplied under a consumer contract for sale are incorrectly installed, any lack of conformity resulting from the incorrect installation is deemed to be a lack of conformity of the goods if:

- (a) the goods were installed by the seller or under the seller's responsibility; or*
- (b) the goods were intended to be installed by the consumer and the incorrect installation was due to a shortcoming in the installation instructions.*

COMMENTS

A. General

This Article addresses incorrect installation as a special case of lack of conformity in a consumer contract for sale. The Consumer Sales Directive has introduced this special instance of the seller's liability, which actually covers two different scenarios: incorrect installation by the seller or under the seller's responsibility and incorrect self-installation by the buyer. In both cases, the buyer may resort to the remedies for lack of conformity set out in Chapter 4, Section 2.

B. Incorrect installation by the seller or under the seller's responsibility

The parties can agree that the seller will install the goods sold to the buyer. Such a sales contract actually also contains a certain element of services, i.e. the installation work undertaken by the seller. Instead of splitting the transaction into a sales part and a services part, under the present rule a lack of conformity resulting from an incorrect installation is qualified as a lack of conformity of the goods. If the goods do not conform to the contract after the installation, it does not matter whether they were initially unfit or whether something went wrong during the installation.

Illustration 1

A buys a kitchen from B, a business selling kitchen furniture. B delivers the kitchen to A's home, where it is subsequently installed by B's workers. After the installation, the buyer notices scratches on one of the doors. Whether or not the scratches were initially on the door or were caused during installation, the seller will be liable for lack of conformity.

Illustration 2

The facts are the same as in illustration 1 but the installation has been poorly done in that the work-surfaces are not level and the doors and drawers in the units do not close properly. The seller will be liable for lack of conformity.

The aim of the article is to protect the buyer against the situation where the goods are damaged during the installation or simply do not function properly as a result of the installation.

For the purposes of (a), it does not matter whether the seller has actually carried out the installation personally, since a contracting party who delegates performance to another remains responsible for the performance (see III.-2:106 (Performance entrusted to another)).

Illustration 3

The facts are the same as in illustration 1, but B has entrusted the installation work to C an independent joiner and cabinet-maker.

C. Incorrect installation by the consumer

Frequently, consumers buy goods that are intended for self-installation (i.e. installation by the buyer in person), typical examples being furniture bought in flat-pack form. If the consumer fails to install the goods correctly, the seller will be liable for the resulting lack of conformity of the goods provided two conditions are met: first, the goods have to be intended to be installed by the consumer; and, Secondly, the installation went wrong due to shortcomings in the installation instructions.

Illustration 4

A buys a TV table at a department store. After assembling the table according to the enclosed instructions, he puts his TV on the table. After two days, the table collapses as the instructions failed to make it clear which of the different screws provided should be used to fasten the legs and the consumer used the wrong ones.

Illustration 5

A buys a computer from B. Even after hours of careful reading of the extensive manual, he does not manage to install the computer correctly. This case, albeit an example of an 'overflow' of information, still qualifies as a shortcoming in the installation instructions, if a reasonable user would not have been able to comprehend the instructions.

In fact, it does not matter whether the buyer actually carried out the wrong installation, as long as these two criteria are met. In other words, any person failing in the assembly on behalf of the buyer, such as a friend or neighbour, can give rise to the seller's liability under this rule. This even applies if the buyer has charged a professional with the assembly, because the buyer would otherwise be worse off than if he or she had tried personally to do the assembly.

Illustration 6:

A buys a sink at a 'DIY' store, which can be installed without professional help. A asks B, a professional plumber, to help him, since A is notoriously impractical. However, due to some major flaw in the installation instructions even B does not manage to install the sink properly.

As for the question whether the seller is under an obligation to provide installation instructions in the first place cf. IV.A.-2:302 (Fitness for purpose, qualities, packaging) sub-paragraph (e).

C. Remedies of the buyer

In the two cases of incorrect installation covered by the Article, the consumer can resort to all the remedies set out in Chapter 4, Section 2. This may, at least in some cases, lead to the seller having to fix the lack of conformity at the buyer's residence. While this consequence may seem harsh, the present rule serves as an incentive for sellers to provide correct installation instructions. In other cases it might be sufficient that the seller provides the buyer with correct installation instructions.

IV.A.-2:305: Third party rights or claims in general

The goods must be free from any right or claim of a third party. However, if such right or claim is based on industrial property or other intellectual property, the seller's obligation is governed by the following Article.

COMMENTS

See the Comments on the following Article.

IV.A.-2:306: Third party rights or claims based on industrial property or other intellectual property

(1) The goods must be free from any right or claim of a third party which is based on industrial property or other intellectual property and of which at the time of the conclusion of the contract the seller knew or could reasonably be expected to have known.

(2) However, paragraph (1) does not apply where the right or claim results from the seller's compliance with technical drawings, designs, formulae or other such specifications furnished by the buyer.

COMMENTS

A. Relation to the notion of conformity

This and the preceding Article make it clear that the notion of conformity covers so-called legal defects as well as material or corporeal shortcomings. The wording of IV.A.–2:301 (Conformity with the contract) sub-paragraph (d), which requires the goods to ‘comply with the remaining Articles of this Section’, embraces these rules in the notion of conformity. As a result, the rules on conformity, subject to one exception in IV.A.–4:302 (Notification of lack of conformity) paragraph (4), do not distinguish between legal and material defects.

B. Third party rights or claims in general

According to IV.A.–2:305 (Third party rights or claims in general), the seller has to ensure that the goods are free from any right or claim of a third party.

Illustration 1

B buys a car from S. A couple of days later he is contacted by C who claims that he has bought the car from S two weeks ago and presents the sales contract. B can claim that S should rectify this situation; otherwise B may terminate the contractual relationship.

In this context, it is important to note that a claim is not synonymous with a right. A “claim” is a demand for something based on the assertion of a right. (See Annex 1.) In the present context the reference to the goods being “free from” a claim implies that the claim must be sufficiently well-founded to affect the goods. A totally and obviously unfounded claim would not attach to or affect the goods in any way.

In addition, it should be noted that the rules of this Part also apply, with appropriate adaptations, to the sale of rights, some of which are by definition split, or rather derived, from another right. Naturally, the existence of such a ‘mother’ right does not qualify as a third party right under this Article. An appropriate adaptation is here called for.

C. Third party rights or claims based on industrial property or other intellectual property

While the preceding Article addresses third party rights and claims in general, the present Article introduces a special regime for third party rights or claims based on industrial property or other intellectual property. Basically, these regimes differ in two respects. First, the seller is not strictly liable for such rights, if the seller did know and could not reasonably be expected to have known of their existence (see paragraph (1)). In essence, this is a deviation from the usually strict standard of liability for other types of lack of

conformity under the present rules. And, secondly, the seller can escape liability for third party rights or claims based on industrial property or other intellectual property, if they stem from the buyer's sphere. Basically, this exception relates to contracts for the sale of goods which the seller has manufactured or produced to the buyer's order. If the seller has complied with specifications furnished by the buyer, the seller is not held responsible for any rights or claims of a third party.

IV.A.-2:307: Buyer's knowledge of lack of conformity

(1) The seller is not liable under IV.A.-2:302 (Fitness for purpose, qualities, packaging), IV.A.-2:305 (Third party rights or claims in general) or IV.A.-2:306 (Third party rights or claims based on industrial property or other intellectual property) if, at the time of the conclusion of the contract, the buyer knew or could reasonably be assumed to have known of the lack of conformity.

(2) The seller is not liable under IV.A.-2:304 (Incorrect installation in a consumer contract for sale) sub-paragraph (b) if, at the time of the conclusion of the contract, the buyer knew or could reasonably be assumed to have known of the shortcoming in the installation instructions.

COMMENTS

A. General

This Article makes it clear that the buyer cannot rely on any lack of conformity of which he knew or should have known when concluding the contract. In effect, this provision introduces a certain restriction as to the scope of the seller's liability by making sure that certain defects do not amount to a lack of conformity. It therefore balances the otherwise strict liability of the seller under the present rules.

The rationale of this Article is to maintain the equilibrium of the contract. That is to say that a buyer, who knew of a lack of conformity, should have taken that fact into account when deciding whether to buy the goods.

In a way, this provision is the other side of the coin of the buyer's reasonable expectations, which feature so prominently in IV.A.-2:202 (Fitness for purpose, qualities, packaging). There, the seller is held liable for reasonable expectations on the part of the buyer in respect of properties of the goods to be sold. By the same token, the buyer may have negative expectations, i.e. may actually know of the lack of conformity of the goods.

The case of incorrect installation under a consumer contract for sale is covered separately in paragraph (2) because in such a case the buyer could not possibly know of the defective installation at the time of conclusion of the contract. The buyer could, however, have known that installation instructions were defective.

Illustration 1

A is interested in buying a glass shower curtain for her bathroom in flat-pack form and identifies an apparently attractive model. The sales person says however “I don’t recommend that one because the installation instructions are hopelessly inadequate.” B replies “Don’t worry. I am good at working out these things and have fitted similar ones before.”

In this case the seller would not be liable under IV.A.–2:304 (Incorrect installation in a consumer contract for sale) sub-paragraph (b) even if A does install the goods incorrectly as a result of the inadequacy of the instructions.

B. Knowledge on the part of the buyer

Obviously, it will be quite difficult to establish that the buyer had knowledge about the lack of conformity of the goods upon the conclusion of the contract. In this context, one question features prominently in sales law: to what extent does the buyer have to examine the goods before concluding the contract? Under the present rules, the buyer is not obliged to examine the goods before purchase. The buyer will only have no remedy if the buyer actually knew of the non-conformity or, when actual knowledge cannot be proved, if it can reasonably be assumed that the buyer must have known (for example, because the buyer inspected the goods closely and the non-conformity was evident).

This Article differs in two important respects from IV.A.–4:301 (Examination of the goods). First, the present Article does not cut off remedies that the buyer could otherwise have resorted to, as it already rules out a lack of conformity as the possible trigger for the remedial process. Secondly, it applies at an earlier stage, namely at the time of the conclusion of the contract (as opposed to the time of delivery under IV.A.–4:301). The Article is without prejudice to other potentially relevant rules in Book II relating to the invalidity of a contract on such grounds as mistake, fraud, and duress.

C. Exceptions

It will be noted that the Article is limited to liability under the specified default rules. It does not apply to liability under the express terms of the contract. In such a case the contract will apply according to its terms. Thus, if the goods have certain shortcomings at the time of the conclusion of the contract, but the parties, expressly or impliedly, agree that the seller is to remedy those shortcomings before the time of delivery, the seller is not exempted from liability under this provision. Similarly, if the parties have expressly agreed upon certain features, then the buyer can expect that the seller will provide these features upon delivery, even if they were lacking at the time of concluding the contract.

Illustration 2

A informs B, a car dealer, that he wants to buy a roadworthy car. B accepts this requirement. They inspect a vehicle prior to concluding the deal. The car in question still has heavily used tyres, which render the car unroadworthy. The buyer notices this fact but still agrees to purchase the car on the agreed condition

as to roadworthiness. The seller is not exempted from liability by the buyer's knowledge, since the buyer can expect that the seller will remedy the defect, i.e. by fitting new tyres before delivery.

At the end of the day, the relationship between the parties' agreement and the buyer's knowledge of certain defects will have to be solved through contract interpretation. Important features here will be whether it was reasonable for the buyer to expect that the seller would remedy the defect before delivery. Also the contract price can provide an indication as to which standards the buyer can expect to be met.

This Article does not apply to IV.A.-2:203 (Statements by third persons) because the relevant provision in II.-9:102 (Certain pre-contractual statements regarded as contract terms) already contains a separate, quite similar restriction in paragraph (2).

D. Consumer contract for sale

While the requirements in this Article depend upon the circumstances of each case, consumer transactions should generally be treated with more caution. Above all, the question of when the consumer could be assumed to have known of the lack of conformity is to be judged with the benefit of doubt. However, the consumer may still have to notice obvious shortcomings.

IV.A.-2:308: Relevant time for establishing conformity

(1) The seller is liable for any lack of conformity which exists at the time when the risk passes to the buyer, even if the lack of conformity becomes apparent only after that time.

(2) In a consumer contract for sale, any lack of conformity which becomes apparent within six months of the time when risk passes to the buyer is presumed to have existed at that time unless this is incompatible with the nature of the goods or the nature of the lack of conformity.

(3) In a case governed by IV.A.-2:304 (Incorrect installation in a consumer contract for sale) any reference in paragraphs (1) or (2) to the time when risk passes to the buyer is to be read as a reference to the time when the installation is complete.

COMMENTS

A. General

This Article defines the time when conformity, or a lack of conformity, is to be established for the purpose of the seller's liability for lack of conformity. In this context, there are two different questions. First, at what point in time does a lack of conformity have to be in existence in order to give the buyer a remedy? And, Secondly, when does it have to become apparent to the buyer? While the answer to the second question can be found in Chapter 4, Section 3 (Requirements of examination and notification), this

Article contains the answer to the first question. In essence, the relevant point in time is normally determined by the passing of risk, but this has to be modified for cases governed by the rules on incorrect installation. Paragraph (2) contains a presumption as to the existence of a lack of conformity in favour of consumers.

B. Existence of the lack of conformity

As a rule, the seller is only liable for a lack of conformity which existed at the time when the risk passed. This rule is justified on various grounds. First, the passing of the risk means that the goods have left the seller's sphere of influence, in accordance with the main rule in IV.A.-5:102 (Time when risk passes) paragraph (1), so that the seller can no longer control them. It would therefore be unfair to burden the seller with liability for a lack of conformity emerging in respect of goods that are outside the seller's control. Secondly, this rule ensures that the buyer assumes the risk of payment, as defined in IV.A.-5:101 (Effect of passing of risk), together with the risk of lack of conformity.

Illustration 1

A sells cattle to B. After five months the animals start to show the first signs of a serious disease. The seller can be held liable only if the defect, that is the disease, was present at the time when the risk passed. If the cattle have only been infected in B's cowshed and, hence, after delivery, the seller is not responsible.

Generally, the risk will pass when the buyer takes over the goods, or should have taken them over, or when the goods are handed over to the first carrier (see the rules in Chapter 5). However, under a consumer contract for sale, the risk generally does not pass until the buyer actually takes over the goods (cf. IV.A.-5:103 (Passing of risk in a consumer contract for sale)). It follows from the passing of risk choice as the relevant point in time that, in the exceptional case where risk passes before actual delivery, the lack of conformity may also have to be in existence before the buyer actually takes charge of the goods (see IV.A.-5:201 (Goods placed at buyer's disposal), IV.A.-5:202 (Carriage of the goods) and IV.A.-5:203 (Goods sold in transit)).

Illustration 2

The facts are the same as in the previous illustration. If the risk passes before handing over the cattle, for instance due to default on the part of the buyer, and the cattle were subsequently infected by a virus without fault on the part of A, B has no claim despite the fact that the infection took place on A's farm.

C. Reversal of burden of proof in a consumer contract for sale

The general rule is that the buyer has to prove that the lack of conformity existed when the risk passed, which will often be rather difficult to establish. In order to facilitate this task, paragraph (2) lays down a short-term reversal of the burden of proof in favour of consumers: any lack of conformity becoming apparent within the first six months after the passing of the risk is presumed to have existed at that time. Under IV.A.-5:103 (Passing of risk in a consumer contract for sale)), risk passes when the consumer takes

over the goods. In essence, this rule resembles a product guarantee, albeit that the seller can still rebut this presumption.

Illustration 3

B, a consumer, buys a washing machine from A, a white-goods dealer. After four months it stops working due to a short circuit. The defect in the wiring is presumed to have existed at the time of the passing of the risk – i.e. when the buyer got the machine. It is up to the seller to prove that this was not the case.

As a consequence of paragraph (2), the consumer buyer has an incentive to lodge a complaint early, as the buyer will then be exempted from the difficult issue of proof. By the same token, a consumer buyer may want to check the goods for lack of conformity, even though under no duty to do so (cf. IV.A.–4:301(Examination of the goods) paragraph (4)).

This presumption applies unless it is incompatible with the nature of either the goods or the lack of conformity.

Illustration 4

A buys a cat from a pet shop. After 2 months of apparent good health the animal develops and then dies of a viral infection. Since the virus in question has an incubation period of just two weeks, and has very obvious symptoms, the presumption has no effect, as it is not compatible with the nature of the lack of conformity.

Illustration 5

A consumer cannot rely on the presumption when cheap straw sandals disintegrate after a long summer outdoors. This is an example of usual wear and tear of goods due to the nature of those goods.

D. Incorrect installation cases

Paragraph (3) has a special rule for cases where a consumer claims that the seller is liable for a lack of conformity under IV.A.–2:304 (Incorrect installation in a consumer contract for sale). It is obvious that in such a case the time when any lack of conformity has to be assessed cannot be the time when risk passes in relation to the goods themselves (which will generally be prior to their installation). So paragraph (3) provides that in such a case the lack of conformity has to exist at the time when the installation is complete. The presumption in paragraph (2) still applies but with this time as the starting point.

IV.A.–2:309: Limits on derogation from conformity rights in a consumer contract for sale

In a consumer contract for sale, any contractual term or agreement concluded with the seller before a lack of conformity is brought to the seller's attention which directly or

indirectly waives or restricts the rights resulting from the seller's obligation to ensure that the goods conform to the contract is not binding on the consumer.

COMMENTS

A. General

This Article attempts to set out the limits of derogation for consumer contracts for sale concerning the conformity requirements in this Chapter. In doing so, it is complemented by IV.A.-4:102 (Limits on derogation from remedies for non-conformity in a consumer contract for sale), which has a similar provision for the consumer's remedies for lack of conformity. This Article is closely related to the principle enshrined in IV.A.-1:301 (Rules not mandatory unless otherwise stated).

B. Derogation from the conformity rules in a consumer contract for sale

In a consumer contract for sale, the buyer's rights under Section 3 of this Chapter in respect of the seller's obligation to ensure that the goods conform to the contract cannot be waived or restricted by the seller before the consumer notifies the seller of the defect. After that moment in time, the parties are free to agree upon other solutions than envisaged in this Chapter. Thus, this Article prevents the seller from restricting the rights of a consumer beforehand, for instance in standard terms.

This provision has the effect that all the rules exclusively applicable to consumer contracts for sale, for instance IV.A.-2:304 (Incorrect installation in a consumer contract for sale) and IV.A.-2:308 (Relevant time for establishing conformity) paragraph (2) cannot be derogated from, unless in the (unlikely) event that the consumer is granted more far-reaching rights. Moreover, generally the provisions common to consumer and other sales will have the same effect, for instance IV.A.-2:205 (Third party rights or claims in general) and IV.A.-2:308 (Relevant time for establishing conformity) paragraph (1).

However, IV.A.-2:301 (Conformity with the contract) and IV.A.-2:302 (Fitness for purpose, qualities, packaging) are the rules that raise the most difficult questions as to how far the parties can deviate from what is laid down in these rules. The problem is that these Articles are strongly connected to the individual agreement between the parties. On the one hand, the parties should for instance be able to conclude a contract for the sale of goods that are not fit for their ordinary purpose. This should only be possible, however, where there is a special reason or this is clearly indicated in the description of the goods, for instance that they are substandard or second hand. In order for the seller to exclude the application of the requirement in IV.A.-2:302(b) that the goods must be fit for the purpose for which goods of the same description would ordinarily be used this limitation must be clearly indicated in the contract (cf. also Comment A to that Article).

Illustration 1

A, a car dealer, sells a car to B, a consumer. The car has been severely damaged in an accident, but B intends to use it for spare parts only. It is clear that the car is not fit for driving on roads, the ordinary purpose for which cars are used. The seller will nevertheless not be liable under IV.A.–2:302(b) if it is clearly stated that the car is sold as a ‘write-off’ and ‘for parts only’.

On the other hand, the seller will generally not be able to exclude the scope of IV.A.–2:302 without a special reason, particularly in the case of new goods which are not sold as substandard. Even in the case of durable second-hand goods like cars, the seller may not rely on a general description such as a ‘wreck’ or ‘kit car’ if the other circumstances, such as the price or the fact that the car is still being driven on public roads, indicate otherwise.

Moreover, the seller should not be able to exclude the elements in IV.A.–2:302 through standard terms. Normally, an individual agreement will be necessary. At the end of the day, the question to which extent the parties under a consumer contract for sale may exclude the scope of IV.A.–2:302 beforehand will depend on the concrete case and will ultimately have to be resolved by means of a case-by-case analysis of the circumstances.

CHAPTER 3: OBLIGATIONS OF THE BUYER

Section 1: Overview

IV.A.–3:101: Overview of obligations of the buyer

The buyer must:

- (a) pay the price;*
- (b) take delivery of the goods; and*
- (c) take over documents representing or relating to the goods as may be required by the contract.*

COMMENTS

A. Main obligations of the buyer

This Article lists three obligations of the buyer that are typically found in sales transactions. They correspond to the main obligations of the seller set out in Chapter 2 and serve as an overview of the buyer’s obligations. The parties are, of course, free to regulate the content of their obligations, in accordance with IV.A.–1:301 (Rules not mandatory unless otherwise stated). So a buyer may not be subject to all the obligations set out in this Article. Most obviously, many sales do not involve documents and so the contract will not require the buyer to take delivery of such documents. But even in a non-

documentary sale, the buyer may not be under an obligation to take delivery of the goods, as they may already be held by the buyer or it may have been agreed that they should remain in the seller's possession (cf. the corresponding issue for the seller's obligation to deliver in IV.A.-2:101 Comment C). Besides, even where the contract requires the seller to deliver the goods, the buyer may not have to do anything to "take" delivery.

Illustration 1

M, a local dairy, offers free delivery of fresh milk to its customers in the vicinity. The milk is delivered in bottles, which are left at the buyers' premises, i.e. in front of the door. The dairy performs its obligation to deliver the goods by merely placing the bottles on the doormat, and there is no corresponding obligation on the buyer to actually take charge of the goods.

In addition, the buyer may also have to comply with a number of obligations arising from the particular agreement between the parties. There may, for example, be an obligation to allow the seller to have access to premises in order to install the goods or an obligation to pay export duties or to bear the cost of chartering a vessel. Additional obligations for the buyer will almost always be involved in mixed contracts, such as a contract for the sale of machinery and the provision of training in its operation.

B. Obligation to pay the price

The obligation to pay the price is essential for a sales contract in the strict sense. However, if parties agree to exchange goods for other goods, the present rules also apply to such a barter contract, see IV.A.-1:203 (Contract for barter).

The present rules do not contain provisions relating to the determination of the price, since such rules are already contained in Book II. See II.-9:104 (Determination of price), II.-9:105 (Unilateral determination by a party), II.-9:106 (Determination by a third person) and II.-9:107 (Reference to a non-existent factor). Nor do they contain provisions on the place and time for payment or on the currency of payment since those matters are regulated in Book III. See III.-2:101 (Place of performance), III.-2:102 (Time of performance) and III.-2:109 (Currency of payment). However, Section 1 of the present Chapter sets out two additional rules relating to the payment of the price: IV.A.-3:202 (Formalities of payment) and IV.A.-3:203 (Price fixed by weight).

If the buyer refuses to pay the price, the seller may sue for the price. However, the right to do so is qualified by III.-3:301 (Monetary obligations) paragraph (2). If it is clear that the buyer does not want the goods, the seller cannot sue for the price if the seller could have arranged a substitute transaction without significant effort or expense, or performance would be unreasonable in the circumstances. If the seller cannot sue for the price, the seller will terminate the contractual relationship and sue for damages for the loss suffered as a result of the buyer's non-performance.

C. Obligation to take delivery of the goods

The present Article, and the more detailed provisions in Section 3, make it clear that the buyer is under an obligation to take delivery of the goods. It is important to note that this is a genuine obligation of the buyer, that is to say, that the buyer's failure to take delivery of the goods gives rise to remedies on the part of the seller.

Therefore the present rules do not embrace the idea of taking delivery as a soft obligation, which merely results in *mora creditoris* rather than an enforceable right to performance by the seller.

In practice, the seller's right to force the buyer to take delivery will seldom arise. To start with, a buyer who has actually paid the price will be unlikely to refuse to take delivery. The seller will only need to force the buyer to also take delivery in exceptional situations, for instance if the maintenance of the goods is expensive or if the goods take up too much storage space. Moreover, the seller will have extensive rights to deposit the goods at another place or to sell the property elsewhere, according to III.-2:111 (Property not accepted). If the buyer also refuses to pay the price the seller will probably first sue for the price (cf. Comment B). Finally, it has already been pointed out in Comment A above that the contract may not require the buyer to take delivery at all.

D. Obligation to take delivery of the documents

The contract may require the seller to transfer documents to the buyer. Basically, there are two groups of documents: those representing the goods; and those relating to the goods. Again, the contract has to answer the question of whether the buyer is under an obligation to take delivery of such documents.

E. Remedies of the seller

If the buyer fails to perform the obligations under the contract, the seller is entitled to the normal remedies for non-performance of an obligation.

IV.A.-3:102: Determination of form, measurement or other features

(1) If under the contract the buyer is to specify the form, measurement or other features of the goods, or the time or manner of their delivery, and fails to make such specification either within the time agreed upon or within a reasonable time after receipt of a request from the seller, the seller may, without prejudice to any other rights, make the specification in accordance with any requirements of the buyer that may be known to the seller.

(2) A seller who makes such a specification must inform the buyer of the details of the specification and must fix a reasonable time within which the buyer may make a different specification. If, after receipt of such a communication, the buyer fails to do so within the time so fixed, the specification made by the seller is binding.

COMMENTS

A. General

The parties can agree upon the conclusion of the contract that the buyer has to make certain specifications relating to the goods to be sold. In principle, it is up to the buyer to make these specifications, which then become part of the standard of conformity. If the buyer fails to do so, however, the seller has a right to make the choice instead. Not only does this rule allow the seller to crystallise the contractual obligations under the contract in respect of delivery and conformity, but it also minimises the buyer's opportunities to avoid or delay performance of the buyer's obligations by failing to make the necessary specifications.

B. The seller's right to make specifications

The starting point for this Article is an agreement between the parties that allows the buyer to specify certain features of the goods, or the time or manner of their delivery, after the conclusion of the contract.

Illustration 1

B agrees to buy a car from S, to be delivered a month later. B is to specify the type of tyres she wants within a week. After a week, B has not contacted the seller, and S writes to the buyer to specify that the car will be delivered with standard tyres, and requests B to inform him within ten days if she does not agree with the choice. B does not reply. The seller's choice is then binding.

Illustration 2

S has sold a certain quantity of copper to be delivered over a period of three years in quarterly instalments to B. The buyer is to specify the quantity of every quarterly instalment by 'delivery orders' four weeks in advance. After a year B fails to do so. S may then make the specification in accordance with the procedure under this Article.

If the buyer fails to make the specifications, either within the time agreed upon or upon the request of the seller, the seller has a right to make the specification subject to certain requirements. First, the seller has to take into account any known requirements of the buyer, e.g. the intended use of the goods. Secondly, the seller has to follow the procedure set out in paragraph (2). Accordingly, the seller has to inform the buyer of the specification and provide a possibility to make a different choice. Then the buyer has some time to react, after the expiry of which the seller's choice becomes binding.

In addition to the right of specification, this Article makes it clear that the seller may also exercise any other rights, for instance claiming damages for any loss caused by the delay.

C. Consumer contract for sale

It is important to point out that the parties must have reached a binding agreement in the first place, in order for this Article to apply. In many cases, particularly a consumer contract for sale, the failure to agree on an important question, for instance the colour of a new car, will mean that there is no contract at all.

D. Relationship with Book III

The present Article, which reflects the CISG, is more specific than the rule in III.–2:105 (Alternative obligations or methods of performance) and displaces that rule to the extent of any inconsistency. (See I.–1:102 (Interpretation and development) paragraph (5) – special rule prevails over general rule.) It offers more safeguards to the buyer. According to III.–2:105(2), the right to choose passes immediately to the seller if the delay in making a choice is fundamental; otherwise the seller is obliged first to give a notice determining an additional period of reasonable length in which the buyer must choose, before the right to choose passes to the seller.

Section 2: Payment of the price

IV.A.–3:201: Place and time for payment

The place and time for payment are determined by III.–2:101 (Place of performance) and III.–2:102 (Time of performance).

COMMENTS

A. General

The buyer performs the obligation to pay only if payment is tendered at the right place and time. In the absence of an agreement between the parties, the general rules on performance in III.–2:101 (Place of performance) and III.–2:102 (Time of performance) apply. In practice these important matters will generally be regulated by the contract.

B. Place and time for payment

According to III.–2:101 (Place of performance) paragraph (1)(a), the buyer has to pay at the creditor's place of business. This means the place of business at the time payment is due.

According to III.–2:102 (Time of performance), the buyer has to pay at the time, or at any time within a period, fixed by or determinable from the sales contract. In the absence of such an agreement, the buyer has to pay within a reasonable time after the obligation to pay arises. Unless the buyer has agreed to pay in advance of delivery, the obligation to pay will normally arise when the seller is ready to deliver. This is because of the principle

of concurrent performance of the parties' obligations (see III.–2:104 (Order of performance)).

Accordingly, the buyer can, in the absence of any agreement to the contrary, withhold performance under III.–3:401 (Right to withhold performance of reciprocal obligation) until the seller delivers, or tenders delivery, of the goods.

IV.A.–3:202: Formalities of payment

The buyer's obligation to pay the price includes taking such steps and complying with such formalities as may be necessary to enable payment to be made.

COMMENTS

This Article is an application to sale of the general rule in III.–2:113 (Costs and formalities of performance). It can be seen, in so far as the steps must be taken in co-operation with the seller, as a specific instance of the general obligation to co-operate under III.–1:104 (Co-operation). For the rest it merely avoids any doubt about what the buyer must do. The buyer has to take the necessary steps, and to comply with any formality, in order to enable payment to be made. The rule emphasises the importance of timely payment.

IV.A.–3:203: Price fixed by weight

If the price is fixed according to the weight of the goods, in case of doubt it is to be determined by the net weight.

COMMENTS

The parties may agree that the buyer has to pay a price based on the weight of the goods. In this case, the question is what constitutes the weight and, thus, the price due. The default rule is that weight refers to net weight.

Illustration 1

A Dutch supermarket chain concludes an agreement with a Greek farming co-operative for the delivery of original feta cheese from Greece during a period of one year. The parties agree on a price per kilo; the cheese is shipped in dark plastic boxes filled with a salty liquid to keep the Feta cheese fresh. It follows from this Article that the Dutch buyer, unless agreed otherwise, need pay only for the cheese, and not for the liquid and the packaging.

The reference to the agreement between the parties emphasises the subordinate role of the net-weight rule. Since it is a mere default rule, the parties are free to agree otherwise.

Section 3: Taking delivery of the goods

IV.A.–3:301: Taking delivery

The buyer fulfils the obligation to take delivery by:

(a) doing all the acts which could reasonably be expected in order to enable the seller to perform the obligation to deliver; and

(b) taking over the goods, or the documents representing the goods, as required by the contract.

COMMENTS

A. General

This Article requires the buyer to co-operate with the seller to enable delivery to be made and to actually take over the goods or documents. Thus, the notion of taking delivery is broader than the actual term may suggest. The rule is, like other rules not declared to be mandatory, a default rule. The contract may make other provision for the taking of delivery.

The buyer's obligation to take delivery is framed as an obligation that the seller, in principle, can enforce. However, as already noted, the buyer may not have to take any further steps in order to comply with the obligations under the contract. To start with, the goods may already be in the buyer's possession or it may have been agreed that they should remain in the seller's possession. Besides, the contract may not require the buyer to take the goods from the seller upon delivery, either because the seller merely has to deposit the goods at the buyer's premises (see Illustration 1 below), or because the seller has to deliver the goods to a third person. In either case, however, the buyer may still have to facilitate delivery by the seller (see Comment B).

B. Enabling the seller to deliver

According to sub-paragraph (a), the buyer must enable the seller to perform the obligation to deliver. In the default rule case where the seller's obligation to deliver is performed merely by making the goods available to the buyer at the seller's place of business (cf. IV.A.–2:2101 (Delivery) paragraph (1)) this paragraph is not relevant; the buyer's obligation is to take the goods under sub-paragraph (b). However, where the contract provides for the seller to deliver in some other way, for example by bringing the goods to the buyer's premises, sub-paragraph (a) is crucial. The buyer is obliged to co-operate with the seller by taking such action as can reasonably be expected to enable the seller to deliver. This may include the designation of the precise place to which the seller should send the goods or having personnel ready to receive the goods. Likewise, the buyer may be obliged to co-operate in times of civil strife, special border controls, and the control of epidemics etc. In such cases, the buyer has to inform the seller of any special problems and of the required formalities to transfer the goods.

Sub-paragraph (a) also imposes obligations on the part of the buyer in cases where the buyer does not have to take charge of the goods or documents (see Comment A). Thus, the seller can force the buyer to co-operate in performing the obligation to deliver the goods.

Illustration 1

The parties may agree that the seller, a quarry, has to deliver a quantity of marble tiles by delivering them to the construction site operated by the buyer, a building constructor. In this case, the seller delivers the goods by a unilateral act, which does not require the buyer to take delivery. However, the buyer still has to co-operate with the seller with a view to enabling him to make the delivery, by telling him where the premises are and the times at which they are accessible.

C. Taking over the goods or the documents

The buyer's obligation to take over the goods or documents under sub-paragraph (b) corresponds to the functional definition of delivery in IV.A.–2:201 (Delivery) paragraph (1), which requires the seller to make the goods available to the buyer, something which can be achieved by different methods (for examples, see IV.A.–2:201 Comment C).

By and large, the buyer's obligation to take delivery mirrors the seller's obligation to deliver. Accordingly, taking over can mean different things. To start with, both parties interact directly: the seller hands over the goods, or keys, which the buyer takes over, i.e. by assuming physical control of the goods. If the seller does not hand over the goods, but otherwise makes them available to the buyer (for example, by preparing the goods for collection at a factory), the buyer takes over by collecting the goods made available by the seller. Finally, the seller can transfer the documents representing the goods, which the buyer may have to take over.

In all these cases, the seller performs the obligation to deliver as the buyer takes over the goods or documents from the seller. However, taking over the goods by the buyer does not necessarily coincide with delivery by the seller. The parties may, for instance, agree that the buyer does not have to collect the goods placed at the buyer's disposal. Moreover, the seller can deliver by taking other measures to enable the buyer to take over the goods from a third party; thus, the buyer eventually takes over the goods from that party. The same holds true in the case of the carriage of the goods under IV.A.–2:201 (Delivery) paragraph (2).

D. Failure to take over the goods or documents

If, under this Article, the buyer fails to take delivery at the place and time determined by IV.A.–2:202 (Place and time for delivery), the seller can exercise the normal remedies for non-performance of an obligation. In practice, the seller will sue the buyer for the purchase price rather than for not taking delivery, unless the right to recover the price is excluded by III.–3:301 (Monetary obligations) paragraph (2). The buyer will normally take over the goods for which payment has been made. If the buyer fails to do so the

seller may dispose of the goods under III.–2:111 (Property not accepted). This means that the seller can either deposit or sell the goods subject to a notification procedure. Another important consequence is the fact that, in a non-consumer contract, the risk passes to the buyer according to IV.A.–5:201 (Goods placed at buyer's disposal). If the goods are lost or damaged during the period of delay, the buyer still has to pay the full price.

This obligation also applies to contracts involving the carriage of goods where delivery is made in accordance with IV.A.–2:101 (Delivery) paragraph (2): first, the buyer has to take charge of the documents representing the goods from the seller, and, secondly, the buyer has to take charge of the goods delivered by the carrier. This second obligation can be justified as follows. The seller, when concluding a contract with a carrier, has an interest in the buyer taking over the goods from the carrier, as the seller may otherwise be liable to the carrier for freight and demurrage.

IV.A.–3:302: Early delivery and delivery of excess quantity

(1) If the seller delivers all or part of the goods before the time fixed, the buyer may take delivery or, except where acceptance of the tender would not unreasonably prejudice the buyer's interests, refuse to take delivery.

(2) If the seller delivers a quantity of goods greater than that provided for by the contract, the buyer may retain or refuse the excess quantity.

(3) If the buyer retains the excess quantity it is deemed to have been supplied under the contract and must be paid for at the contractual rate.

(4) In a consumer contract for sale paragraph (3) does not apply if the buyer believes on reasonable grounds that the seller has delivered the excess quantity intentionally and without error, knowing that it had not been ordered. In such a case the rules on unsolicited goods apply.

COMMENTS

A. Scope

It is already clear that the buyer is under an obligation to take delivery. This Article, however, addresses two special situations: the seller may deliver too early or too much. In both cases, the question arises whether, and to what extent, the buyer is also under an obligation to take delivery of the goods tendered early or the excess quantity.

While this Article establishes a right of the buyer to refuse or take delivery, it also relates to the buyer's obligation to take delivery (as the buyer may, for instance, have to accept the early tender by the seller where the buyer's interests are not unreasonably prejudiced). Moreover, paragraph (3) creates an obligation for the buyer to pay for any excess quantity accepted.

This regulation does not apply in the opposite situations where the seller delivers late or a lesser quantity than agreed upon. For cases where the seller delivers late the general regime in Book III on remedies for non-performance of obligations applies. Where the seller delivers a lesser quantity than agreed upon this will be a non-conformity and the buyer will have the remedies in Book III as modified in Chapter 4 of this Part.

B. Early delivery

There may be cases where the seller delivers all or part of the goods too early. Here, the buyer has a choice (paragraph (1)). On the one hand, the buyer can take delivery, which will allow the seller a right to cure any lack of conformity up until the due date of delivery according to IV.A.–2:203 (Cure in case of early delivery). On the other hand, the buyer can refuse to take delivery; in which case the seller has to deliver once again at the time agreed. This right of refusal is, however, subject to an important restriction, since the buyer must not refuse early delivery if doing so would not unreasonably prejudice the buyer's interests.

Illustration 1

C, a building contractor, orders a set of steel pipes to be delivered to his construction site at noon. If the seller delivers the materials at 10 am, C must not refuse delivery. This may, however, be different if the seller delivers a day earlier or if the construction site is bustling with activity which prevents the buyer from taking delivery at that time.

C. Excess quantity

There may be cases where the seller delivers more than was agreed upon. Here, the buyer can choose between two possibilities. On the one hand, the buyer can refuse delivery of the excess quantity (paragraph (2), which merely confirms what would be the case in any event). On the other hand, the buyer can choose to take delivery of all or part of the excessive amount. Doing so can be considered as a new offer of conforming goods that goes beyond the initial contract. As a consequence, the buyer also has to pay for the excess amount accepted at the contractual rate (see paragraph (3)).

Illustration 2

A, a restaurant owner, buys 10,000 serviettes from S. Upon delivery, it turns out that S has delivered 12,000 instead. According to paragraph (2), A can either refuse the extra 2,000 (and take delivery of the agreed amount), or take delivery of all or part of the excess amount and pay at the contractual rate.

The delivery of an excess quantity falls under the ambit of lack of conformity (cf. IV.A.–2:301 (Conformity with the contract) sub-paragraph (a)). Nevertheless, it should be pointed out that this provision constitutes a special regulation in the case of excess delivery, thus overriding the seller's right to cure under III.–3:202 (Cure by debtor: general rules). The seller is thus not permitted to cure the lack of conformity through taking back the excess quantity (which the seller might want to do if prices have unexpectedly risen). It is up to the buyer to decide whether to retain or refuse the excess

quantity. The decision would have to be made within a reasonable time. The buyer could lose the right to retain the goods unless the seller was notified of the non-conformity within a reasonable time. See III.–1:103 (Good faith and fair dealing) and, for non-consumer cases, III.–3:107 (Failure to notify non-conformity) and IV.A.–4:302 (Notification of lack of conformity).

D. Relationship with rule on early performance in Book III

The general rule in III.–2:103 (Early performance) paragraph (1) establishes the right to decline an early tender, which applies unless the early performance “would not cause the creditor unreasonable prejudice”. Paragraph (2) makes it clear that acceptance of early performance does not affect the time fixed for the performance by the creditor of any reciprocal obligation.

The present rule can be considered an extension of this general rule in several respects. First, it also provides explicitly for the buyer’s right to accept early delivery. Secondly, it addresses cases of excess quantity. And, finally, it sets out the buyer’s obligation to pay for an extra delivery, corresponding to the right to accept it.

CHAPTER 4: REMEDIES

Section 1: Remedies of the parties in general

IV.A.–4:101: Application of Book III

If a party fails to perform an obligation under the contract, the other party may exercise the remedies provided in Book III, Chapter 3, except as otherwise provided in this Chapter.

COMMENTS

A. General

The starting point for the present rules is that, in the event of the non-performance of any obligation by either party under the contract, the aggrieved party may resort to the remedies contained in Book III, Chapter 3 for non-performance of an obligation. However, the wording (“except as otherwise provided in this Chapter”) also makes it clear that the present rules provide for sales-specific rules on remedies which deviate from the general regime.

B. Changes to the regime of remedies provided by Book III

There are not many deviations from the rules on remedies contained in Book III, Chapter 3, which are generally suitable for application to non-performance of obligations under a contract for sale. Some of the deviations are designed to provide greater protection for

consumers who are sold defective goods. Others are designed to provide greater certainty and speed of action in relation to defective goods in commercial sales.

Section 1 contains only one modification of the general remedial regime. Its effect is to limit, in relation to a consumer contract for sale, the parties' freedom to derogate from the normal rules on remedies for non-conformity.

Section 2 contains two sales-specific rules on a buyer's remedies for lack of conformity. One extends the right of a consumer buyer to terminate the contractual relationship for non-performance. The other limits the liability of a consumer seller in certain situations.

Finally, Section 3 contains a special regime concerning the buyer's duty of examination and notification in relation to a lack of conformity. It is not applicable to consumer contracts for sale and is designed to increase certainty in commercial sales by ensuring that defects are notified promptly and that sellers know within a certain time whether they are going to be exposed to claims of non-conformity.

IV.A.–4:102: Limits on derogation from remedies for non-conformity in a consumer contract for sale

In a consumer contract for sale, any contractual term or agreement concluded with the seller before a lack of conformity is brought to the seller's attention which directly or indirectly waives or restricts the remedies of the buyer provided in Book III, Chapter 3 (Remedies for Non-performance), as modified in this Chapter in respect of the lack of conformity is not binding on the consumer.

COMMENTS

A. General

This Article attempts to set out the limits of derogation for consumer sales concerning the buyer's remedies for non-conformity. It is complemented by IV.A.–2:309 (Limits on derogation from conformity rights in a consumer contract for sale), which sets out a similar provision for the conformity of the goods. The Article is one of the exceptions envisaged in IV.A.–1:301 (Rules not mandatory unless otherwise stated).

To have mandatory protection in favour of the consumer regarding remedies follows the approach of the Consumer Sales Directive. Moreover, the consumer will generally only negotiate on the price of the goods and not concerning which remedies will be available when there is a lack of conformity in the goods.

B. Derogation from the rules on remedies in a consumer sale

In a consumer sale, the buyer's rights under Book III, as slightly modified by this Chapter, in respect of the lack of conformity cannot be waived or restricted by agreement

with the seller before the consumer notifies the seller of the defect. After that time, the parties are free to agree upon other solutions than those envisaged in this Chapter. For instance, the buyer, even if a consumer, should be able to agree to pay part of the cost of a repair which under the normal rules the seller would be bound to provide free of charge (cf III.–3:302 (Non-monetary obligations)) paragraph (2). Such an agreement would, however, not be possible before the buyer notifies the seller of the lack of conformity.

This Article prevents the seller from restricting the remedies of a consumer buyer for non-conformity beforehand, for instance in standard terms. For example, the seller cannot exclude in advance the consumer's right to damages, price reduction or termination if the normal requirements for them are fulfilled.

Section 2: Remedies of the buyer for lack of conformity

IV.A.–4:201: Overview of remedies

When the goods do not conform to the contract the buyer is entitled, subject to the provisions of Book III and of this Chapter:

- (a) to have the lack of conformity remedied by repair or replacement in accordance with III. – 3:302 (Non-monetary obligations);*
- (b) to withhold performance under III.–3:401 (Right to withhold performance of reciprocal obligation);*
- (c) to terminate the contractual relationship under Book III, Chapter 3, Section 5 (Termination);*
- (d) to reduce the price under Book III, Chapter 3, Section 6 (Price reduction); or*
- (e) to damages under Book III, Chapter 3, Section 7 (Damages and interest).*

COMMENTS

A. Scope of this section

This section is limited to remedies for the type of non-performance specific to sales contracts, i.e. where the goods do not conform to the contract. Other types of non-performance on the part of the seller, such as delayed performance or no delivery at all, fall under the general regime of remedies for non-performance of obligations in Book III, Chapter 3 subject to the modification in IV.A.–4:102 (Limits on derogation from remedies for non-conformity).

B. General restrictions on the availability of remedies

The words “subject to the provisions of Book III and of this Chapter” are important because they leave room for the operation of important restrictions on the availability of remedies. For example, Book III, Chapter 3, Section 2 has provisions on cure of a non-conforming performance by the person who is bound to perform – in this case the seller. The effect is to introduce a certain hierarchy of responses by the buyer into the remedial

structure: the buyer must normally first give the seller an opportunity to cure the non-conformity before resorting to any remedy other than a temporary withholding of payment. Book III also has an Article (III.–3:107: Failure to notify non-conformity) which for non-consumer cases requires the person entitled to performance – in this case the buyer – to notify the other party within a reasonable time of a lack of conformity if remedies for the non-conformity are to be retained. For commercial sales this is supplemented by IV.A.–4:302 (Notification of lack of conformity) of the present Chapter. It must also be borne in mind that the general rule in III.–1:103 (Good faith and fair dealing) may have the effect of precluding a buyer, whether or not a consumer, from exercising a remedy which would otherwise be available. For example, if a buyer inexcusably failed to notify the seller of a defect for an altogether unreasonable length of time with the effect that the seller was seriously prejudiced by the delay then, quite apart from the specific rules on notification, the buyer might be precluded by the general rule on good faith and fair dealing from founding on the non-conformity.

C. Overview of remedies for lack of conformity

The first Article of Section 2 provides an overview of the remedies available to the buyer, subject to the qualifications noted above, in the case of a lack of conformity. It does so by referring to the applicable remedies under Book III, Chapter 3, while making it clear that in a few respects these remedies may be modified by the present Chapter. In the context of a contract for sale the available remedies are as follows.

Remedying the lack of conformity. The buyer may, subject to the restrictions noted above (and particularly the provision on first allowing the creditor an opportunity to cure the non-conformity voluntarily), enforce performance by having the seller ordered to remedy the lack of conformity free of charge by repair or replacement. The details of this right are elaborated in III.–3:302 (Non-monetary obligations), which contains certain restrictions on the availability of the remedy. The choice between repair or replacement is the seller's.

Withholding performance. In the event of a lack of conformity, the buyer can withhold performance under III.–3:401 (Right to withhold performance of reciprocal obligation). This remedy does not by itself cure, or provide compensation for, the lack of conformity. It rather serves as a means of exerting pressure in order to obtain other remedies. The buyer can refuse to pay until the non-conformity is remedied. This remedy can be used even if the seller has been given an opportunity to cure the non-conformity (see III.–3:204 (Consequences of allowing debtor opportunity to cure) paragraph (1)).

Termination of the contractual relationship. The buyer may, subject to the restrictions noted above, terminate the contractual relationship with the seller under the rules in Book III, Chapter 3, Section 5 (Termination). The effect is that if there is a fundamental non-performance, or a reasonably anticipated fundamental non-performance, by the seller of the latter's obligations under the sales contract the buyer can escape from the contract, refuse to pay and safely buy the goods elsewhere without any fear that the seller will insist on the buyer taking delivery and paying for the goods. This right is extended for

consumers by IV.A.–4:202 (Termination by consumer for lack of conformity) so that in a consumer contract for sale the buyer may terminate for any non-conformity unless the lack of conformity is minor. This is a very considerable relaxation in favour of consumers of the normal requirement that a non-performance be fundamental. It is also possible that the buyer merely terminates part of the contractual relationship in accordance with III.–3:506 (Scope of right when obligation divisible).

Price reduction. The buyer is entitled to a price reduction, again subject to the restrictions noted above, The details of this remedy are elaborated in Book III, Chapter 3, Section 6.

Damages. The buyer may, again subject to the restrictions noted above, claim damages for the lack of conformity. In this context, it is important to note that the buyer may always claim damages for any loss not remedied by the seller's cure (see expressly III.–3:204 (Consequences of allowing debtor opportunity to cure) paragraph (3)).

IV.A.–4:202: Termination by consumer for lack of conformity.

In a consumer contract for sale, the buyer may terminate the contractual relationship for non-performance under Book III, Chapter 3, Section 5 (Termination) in the case of any lack of conformity, unless the lack of conformity is minor.

COMMENTS

This Article extends the right of a consumer buyer to terminate the contractual relationship with the seller. Normally under Book III, Chapter 3 only a fundamental non-performance (defined in Annex 1) would justify termination. This Article enables the consumer buyer to terminate for *any* lack of conformity, provided it is not minor.

While this may seem rather drastic, it should not be overlooked that the provisions on the seller's right to cure mean that the buyer can generally not terminate immediately (see III.–3:202 (Cure by debtor: general rules) and III.–3:204 (Consequences of allowing debtor opportunity to cure)).

Generally, it can be said that the threshold for a minor lack of conformity is below that of a fundamental lack of conformity. A minor lack of conformity constitutes a lack of conformity of slight importance, or a defect which is relatively small in relation to the overall value of the product. It should be presumed that small scratches and other purely cosmetic defects are normally considered to be minor. Furthermore, minor malfunctions in technical equipment that are of no major importance to the buyer should generally not give rise to termination. As a rule, it must be determined in each individual case how the value or the usability is influenced through the lack of conformity in question. If the usability is influenced in a major way, the criterion for termination is fulfilled even if the

lack of conformity only constitutes a marginal reduction in the value. A fact speaking against a more than minor lack of conformity is when the usability can be restored through minor efforts. Generally, a per se less important lack of conformity will become non-minor if it is difficult to remedy. Finally, the fact that the seller has without valid reasons refused to remedy the lack of conformity under III.–3:202 (Cure by debtor: general rules) might influence the question of whether or not the lack of conformity is minor, since the seller has then already been given an opportunity to avoid the termination of the contractual relationship.

IV.A.–4:203: Limitation of liability for damages of non-business sellers

(1) If the seller is a natural person acting for purposes not related to that person's trade, business or profession, the buyer is not entitled to claim damages for lack of conformity exceeding the contract price.

(2) The seller is not entitled to rely on paragraph (1) if the lack of conformity relates to facts of which the seller, at the time when the risk passed to the buyer, knew or could reasonably be expected to have known and which the seller did not disclose to the buyer before that time.

COMMENTS

A. General

This Article limits the liability of non-professional sellers by capping the amount of (contractual) damages due. This limitation only applies in the event of a lack of conformity, as is made clear by the location and the wording of the rule. It therefore introduces a separate rule for sales law, which may be more favourable to the seller than the normal criterion of III.–3:703 (Foreseeability). While this Article will predominantly apply in the case of a sale between two private persons, it also covers the case of a private person selling to a business.

B. Non-professional seller

The definition of the non-professional seller runs parallel to that of a consumer under Annex 1. Accordingly, this Article applies to a natural person not acting to any extent for purposes related to that person's trade, business or profession. In contrast, it does not matter in which capacity the buyer buys the goods. The buyer can therefore be another private person, i.e. a 'consumer', or a business.

C. Damages limited to the amount of the contract price

In order to protect the non-professional seller against excessive claims for damages, the amount of damages is limited to the contract price. This cap on damages can be justified as follows. A far-reaching obligation to pay damages may become excessively onerous to a private seller, sometimes even disrupting the whole financial situation. This is especially true in the, albeit rare, situation where a non-professional seller sells goods to a business, where the seller could, in theory, face a far-reaching claim for damages.

Illustration 1:

Two private persons conclude a sales contract for a second-hand caravan. The buyer, B, tells the seller that he is buying the caravan for travelling from Sweden to Spain for the European football championship. Unfortunately, the caravan breaks down in Germany, after having successfully crossed the bridge and Denmark. The amount of damages could for instance include the repair of the caravan itself, accommodation, alternative transportation to Spain or compensation for tickets that could not be used etc. However, since the seller is not a professional, he will at a maximum be liable for damages equal to the contract price.

Therefore it has been decided to restrain the non-professional seller's obligation to pay damages exceeding the contract price. Even if such a fixed standard may sometimes be inflexible, it was preferred to have a clear-cut rule rather than an open standard. In this way a private party will always know the exact extent of the risk taken, in contrast to having other standards like, for instance, the costs for repair.

Arguably, the arguments brought forward above also apply in respect of a delay in delivery. However, it should be kept in mind that any seller should know whether it is possible to deliver on time, whereas a seller may not envisage the consequences of a lack of conformity.

D. Exception

The cap on damages is subject to an important restriction in paragraph (2), which has a similar function as IV.A.-4:304 (Seller's knowledge of lack of conformity). In both cases, the seller is not entitled to rely on the protective rules, if the seller knew or should have known of the lack of conformity and did not communicate it to the buyer. In such situations, the seller is not worthy of the extra protection offered in paragraph (1).

Illustration 2

The facts are the same as in illustration 1. If the seller already knew about the defectiveness of the caravan without telling the buyer, he will be liable for damages in the normal way even if they exceed the contract price.

Section 3: Requirements of examination and notification

IV.A.-4:301: Examination of the goods

(1) The buyer should examine the goods, or cause them to be examined, within as short a period as is reasonable in the circumstances. Failure to do so may result in the buyer losing, under III.-3:107 (Failure to notify non-conformity) as supplemented by IV.A.-4:302 (Notification of lack of conformity), the right to rely on the lack of conformity.

(2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at their destination.

(3) If the goods are redirected in transit, or redispached by the buyer before the buyer has had a reasonable opportunity to examine them, and at the time of the conclusion of the contract the seller knew or could reasonably be expected to have known of the possibility of such redirection or redispach, examination may be deferred until after the goods have arrived at the new destination.

(4) This Article does not apply to a consumer contract for sale.

COMMENTS

A. General

The buyer should examine the goods delivered by the seller as quickly after delivery as is reasonably possible in order to discover any potential lack of conformity. A failure to do so may indirectly, by preventing timely notification of a non-conformity, cause the buyer to lose rights in respect of the relevant lack of conformity.

This requirement to examine ensures that problems are found and sorted out as soon as possible, which allows for commercial sales transactions to be processed rapidly. Not only does this Article therefore promote the needs of the commercial sector – in particular legal certainty – but it also reflects ordinary commercial practice.

B. Modalities of the requirement to examine the goods

Paragraph (1) requires the buyer to examine the goods ‘within as short a period as is reasonable in the circumstances’. In some cases, the buyer may have to examine the goods immediately upon delivery, while in other cases, it will be sufficient if examination takes place shortly after delivery (for the notion of “reasonable”, see Annex 1; ultimately, the courts will have to determine what is reasonable in a given case).

This Article does not specify how the buyer has to examine the goods delivered. For one thing, such specific procedures for the examination may have been agreed between the parties or may follow from usages or trade practice. In the absence of such indications, the proper procedure will depend on the goods delivered. The buyer may have to take samples, for instance in bulk deliveries, or even have to organise tests in other cases.

Illustration 1

R, a retail chain selling textiles and clothing, bought a few hundred leather jackets from D, a wholesale dealer. The leather jackets were delivered on March 18 to the central warehouse, where they were sorted and packed for distribution to the stores. After distribution to the stores on March 26, the first complaints were received on April 5. In fact, half of the leather jackets turned out to be defective, which was visible to the naked eye (material of a poor quality, wrong colours, poor workmanship). In this situation, R has not complied with the duty to examine

since, at least under a commercial contract, it would have been required to inspect the goods upon delivery, for instance through taking samples.

Paragraphs (2) and (3) take into account two situations where the buyer cannot examine, or have the goods examined, upon delivery: they provide exceptions to the strict time requirements of the main rule of paragraph (1). Even though the risk has passed in both cases (see IV.A.–5:202: (Carriage of the goods) and IV.A.–5:203: (Goods sold in transit)), the buyer is not in a position to examine the goods, since they are not yet to hand. As a result, the buyer may, in the case of the carriage of goods, defer the examination until the goods have arrived at their destination. Secondly, if the goods are redirected or redispached while still in transit, and without the buyer having had a possibility to examine them, the buyer may defer the examination until the goods have arrived at their new destination. This rule does not apply, however, if the seller neither knew nor could have been expected to know of such a redirection or redispach.

C. Failure to examine the goods

While paragraph (1) does not set out the direct legal consequences of a failure by the buyer to examine the goods, it is made clear that such a failure may result in the buyer losing, under III.–3:107 (Failure to notify non-conformity) as supplemented by IV.A.–4:302 (Notification of lack of conformity), the rights to rely on a lack of conformity which, because it was not discovered, was not notified in time. In fact, it is therefore the latter provisions which actually sanction the failure to examine the goods.

Illustration 2

During the process of delivery of fresh edible snails the buyer is informed that the truck was delayed at the border. Upon final delivery, (a) he takes a quick look at the goods and discovers that some of the snails have started to smell; (b) he takes a couple of samples and discovers that the snails have started to decay. In both cases, he notifies the seller that the snails are of poor quality. This example makes it clear that an examination as such has no real consequences since only notification matters. In case (a) the buyer does not even examine properly; but as long as there really was a lack of conformity the timely notification is sufficient to retain his rights. If the superficial ‘examination’ had produced no results, but a thorough examination would have, then the buyer ought to have discovered (and subsequently notified) the lack of conformity.

D. Consumer contract for sale

This Article does not apply in consumer contracts for sale, as is explicitly stated in paragraph (4). As a result, consumers are not required to examine the goods upon delivery. This is consistent with the fact that they also are not affected by the provisions on notification of non-conformity in III.–3:107 (Failure to notify non-conformity) and IV.A.–4:302 (Notification of lack of conformity) (see paragraph (4) of the former Article and Paragraph (1) of the latter).

IV.A.–4:302: Notification of lack of conformity

(1) In a contract between two businesses the rule in III.–3:107 (Failure to notify non-conformity) requiring notification of a lack of conformity within a reasonable time is supplemented by the following rules.

(2) The buyer in any event loses the right to rely on a lack of conformity if the buyer does not give the seller notice of the lack of conformity at the latest within two years from the time at which the goods were actually handed over to the buyer in accordance with the contract.

(3) If the parties have agreed that the goods must remain fit for a particular purpose or for their ordinary purpose during a fixed period of time, the period for giving notice under paragraph (2) does not expire before the end of the agreed period.

(4) Paragraph (2) does not apply in respect of third party claims or rights pursuant to IV.A.–2:305 (Third party rights or claims in general) and IV.A.–2:306 (Third party rights or claims based on industrial property or other intellectual property) .

COMMENTS

A. General

Because rules on notification have an application to sales, leases of goods and services there is a general provision in III.–3:107 (Failure to notify non-conformity). As applied to sales this has the effect that the buyer may not rely on the lack of conformity unless buyer notifies it to the seller within a reasonable time, specifying the nature of the lack of conformity. The reasonable time runs from the time when the goods are supplied or from the time, if it is later, when the buyer discovered or could reasonably be expected to have discovered the non-conformity. However, the seller is not entitled to rely on the buyer's failure to notify if the failure relates to facts which the seller knew or could reasonably be expected to have known and which the seller did not disclose to the buyer. These rules do not apply where the buyer is a consumer: in such a case there is no specific requirement of notification and only the general rule on good faith and fair dealing applies.

The thinking behind these general rules is that the buyer has to indicate any discoverable lack of conformity to the seller, who can then follow up the complaint and ultimately solve the problem. The notification requirement thus aims to resolve quickly any dispute due to non-conforming goods. The requirement applies to any lack of conformity and therefore covers both material and so-called legal defects in the goods.

It should also be mentioned that the rules on prescription in Book III will generally have the effect that the buyer will lose the right to found on a non-conformity three years after the time of delivery of the goods or, if later, the time when the buyer knew of or could reasonably be expected to have known of, the non-conformity. See III.–7:101 (Rights subject to prescription), III.–7:201 (General period), III.–7:203 (Commencement) and III.–7:301 (Suspension in case of ignorance). Regardless of what the buyer knew or

should have known there is prescription after ten years from the due time of delivery (III.-7:307 (Maximum length of period)). These rules on prescription apply to consumer and non-consumer buyers alike.

B. Absolute time period of two years

The present Article supplements these general rules by a special rule for contracts for sale between businesses. It is a rule of a different type from the general notification rules. It does not depend on what the buyer knew or could reasonably be expected to have known. It is not therefore a sort of more specific version of the rule on good faith and fair dealing in the exercise of remedies. It is an automatic cut-off rule, more akin to the rule on the maximum length of prescription. Its effect is that, even if excusably ignorant of the non-conformity, the buyer loses the right to rely on it if it is not notified to the seller within two years from the time at which the goods were handed over. This rule is heavily influenced by the CISG which provides (art. 39(2)) that:

(2) In any event, the buyer loses the right to rely on a lack of conformity of the goods if he does not give the seller notice thereof at the latest within a period of two years from the date on which the goods were actually handed over to the buyer, unless this time-limit is inconsistent with a contractual period of guarantee.

The starting point of the two-year period under paragraph (2) is when the goods are actually handed over to the buyer, meaning when the buyer actually receives the goods and not, for instance, when the goods are handed over to a carrier. This point in time was chosen for reasons of clarity and since only when the buyer has the goods in actual possession can the buyer discover any lack of conformity present.

The rationale of this absolute time-limit is to safeguard the seller against claims brought long after the delivery of the goods. An absolute time-limit allows for a better calculation of costs concerning possible risks stemming from claims from the buyer. Besides, legal certainty is promoted since the seller will know that all transactions are definitely settled after the lapse of a certain period. Furthermore, the costs of legal proceedings increase as time passes, as it becomes more complicated to investigate the causes of a defect and to establish whether it existed at the time of delivery. On the other hand, the interests of the buyer require sufficiently long time-limits for a lack of conformity to become apparent.

The two-year time-limit under paragraph (2) can be changed by express agreement. As the rule applies only to contracts between businesses the limits on derogation in relation to consumer contracts for sale have no application. Accordingly the period can be shortened or lengthened by agreement between the parties.

C. Effect of contractual guarantee

Paragraph (3) clarifies that if the parties have agreed that the goods must remain fit for a particular purpose or for their ordinary purpose during a fixed period of time, the period for giving notice under paragraph (2) does not expire before the end of the agreed period.

This reflects the closing words of the CISG art. 39(2) – “unless this time-limit is inconsistent with a contractual period of guarantee”. A buyer – even if not a consumer buyer – should not lose continuing rights before they have expired.

D. Exception for third party rights or claims

Paragraph (4) exempts rights arising out of third party claims or rights under IV.A.–2:305 (Third party rights or claims in general) and IV.A.–2:306 (Third party rights or claims based on industrial property or other intellectual property) from the two-year time-limit of paragraph (2). Therefore, subject to the normal rules on good faith and fair dealing, the only relevant time-limit is the period of prescription established by Book III, Chapter 7.

E. Consumer contract for sale

It is worth emphasising again that this Article does not apply to consumer contracts for sale but only to contracts between businesses. For consumers therefore, subject to the normal rules on good faith and fair dealing, the only relevant time-limit is the period of prescription established by Book III, Chapter 7.

IV.A.–4:303: Notification of partial delivery

The buyer does not have to notify the seller that not all the goods have been delivered, if the buyer has reason to believe that the remaining goods will be delivered.

COMMENTS

A. General

This provision aims to solve a potential problem associated with the wide definition of non-conformity in IV.A.–2:301 (Conformity with the contract). Since a deficiency in quantity is treated as a lack of conformity under that provision there is a danger that a non-consumer buyer would have to pay for goods which were not received if the seller was not notified of the shortfall within a reasonable time. This article aims to protect the buyer from such a result subject to certain preconditions.

B. No notification required

Under the Article, the buyer is not required to notify the seller of the shortfall in the delivery if the buyer has reason to believe that the seller will deliver the remaining goods. If the buyer, however, is not sure about that the rest of the goods will be delivered, notification to the seller is still required if the buyer wishes to retain rights to rely on the non-performance. This solution can be justified as the seller should know that not all the goods have been delivered, especially if the buyer has good reason to believe this. In this case, the seller therefore needs no notification in order to be informed about the problem.

Illustration 1

The buyer has ordered three tons of oranges, which the seller promised to deliver by lorry. One lorry breaks down; the other delivers half the batch of oranges. The

buyer is informed about the delay. The buyer has reason to believe that the seller will still deliver the missing part and will not lose any rights by failing to notify at that stage.

In this context, price may serve as an indicator. In the case of an overall price, the buyer will, in every likelihood, not expect further delivery; whereas in the case of a unit price, it may be different. Other indicators could be invoices or similar statements relating to the delivery.

An example of circumstances speaking against further delivery is the case of an invoice from the seller that concerns the whole contracted quantity, but a few units are missing.

Illustration 2

The buyer has bought 100 tons of bananas from the seller. The shipment arrives, but it consists of only 90 tons. The invoice refers to the delivery of 100 tons. The buyer has no reason to believe that the seller will still deliver the missing 10 tons, since the invoice shows that the seller thought that the whole quantity had been delivered.

Furthermore, the circumstances of a given case may reveal that a part of the delivery has disappeared during transport, for instance because a box has been broken open. In these and similar circumstances, the buyer does not have reason to believe that a further delivery is forthcoming.

C. Consumer contract for sale

Although consumer contracts for sale are not expressly excluded from the Article they will in fact not be affected by it as a consumer buyer is, in any event, not required to notify in order to retain remedies. See III.–3:107 (Failure to notify non-conformity) paragraph (4) and IV.A.–4:302 (Notification of lack of conformity) paragraph (1). Moreover a consumer buyer who has justifiably assumed that the seller was going to deliver the missing quantity would not be acting contrary to good faith and fair dealing in not notifying the seller of the shortfall.

IV.A.–4:304: Seller's knowledge of lack of conformity

The seller is not entitled to rely on the provisions of IV.A.–4:301 (Examination of the goods) or IV.A.–4:302 (Notification of lack of conformity) if the lack of conformity relates to facts of which the seller knew or could reasonably be expected to have known and which the seller did not disclose to the buyer.

COMMENTS

A. General

Both IV.A.–4:301 (Examination of the goods) and IV.A.–4:302 (Notification of lack of conformity) require the non-consumer buyer to ensure that possible problems with regard to the conformity of the goods are found, indicated and sorted out as quickly as possible upon pain of the loss of the buyer's rights. However, the seller is not entitled to rely on these provisions, which restrict liability for lack of conformity, if the seller knew or should have known of the lack of conformity and did not tell the buyer.

B. Knowledge of the lack of conformity

The crucial question under this Article is whether the seller actually had, or should have had, knowledge of certain facts relating to a potential lack of conformity. While the former variant (positive knowledge of the seller) will burden the buyer with a difficult question of proof, the second variant (what the seller could reasonably be expected to have known) introduces a more objective test. In this context, regard must be had to the economic reality of today's retail business. Final sellers increasingly simply serve as a mere 'point of sale' for highly specialised, mass-produced goods. They will not have taken part in the design and manufacture of these goods and will often lack essential information about the product.

Nonetheless buyers are entitled to expect at least a certain minimum of expertise on the part of the seller. The latter can be expected to be reasonably well informed about the goods sold, not least because the seller will usually handle complaints even if they are passed on to the manufacturers. By and large, the question of what the seller can reasonably be expected to have known will have to be decided on a case-by-case basis.

In addition, the seller needs to disclose these facts to the buyer. However, this rule cannot be construed so as to require the seller to provide an objective and impartial assessment of the goods to be sold, possibly even involving alternatives by competitors and the like.

C. Impact on the buyer's remedies

If the seller is not entitled to rely on the examination and notification requirements under this Section, the buyer does not lose the rights to rely on the relevant lack of conformity by virtue of IV.A.–4:302 (Notification of lack of conformity). There is a virtually identical rule in III.–3:107 (Failure to notify non-conformity) paragraph (3). Moreover the buyer would not in these circumstances be adversely affected by the rules of III.–1:103 (Good faith and fair dealing), given that it is the seller who has acted contrary to good faith and fair dealing. However, the general rules on prescription will still apply. The result is that the buyer can bring a claim as long as it has not expired.

D. Consumer contracts for sale

Although consumer contracts for sale are not expressly excluded from this Article, in fact it has no application to them as consumers are not affected by the two provisions mentioned in it.

CHAPTER 5: PASSING OF RISK

Section 1: General provisions

IV.A.–5:101: Effect of passing of risk

Loss of, or damage to, the goods after the risk has passed to the buyer does not discharge the buyer from the obligation to pay the price, unless the loss or damage is due to an act or omission of the seller.

COMMENTS

A. General

The present Chapter addresses the question of who has to bear the risk of the goods being lost or damaged in a fortuitous event, i.e. due to no fault of either party. This article governs the question of whether the buyer needs to pay the full price for the goods despite their accidental loss or damage (for further aspects of risk, see Comment C).

B. Consequences of the passing of risk under these rules

The present rules address only the aspect of risk obliging the buyer to pay the price if the goods are lost or damaged after the risk has passed. This aspect of risk relating to the buyer is called the risk of counter-performance or, more specifically, the risk of payment. In other words, is the buyer obliged to perform even if the goods are not received at all, or only in a damaged state?

Illustration 1

A buys china from B, a shopkeeper. B hands the china over to A and the parties agree that A will settle the account the next day. That night the china is smashed due to an earthquake. The next day A returns the shattered pieces of china to B and refuses to pay the price. B rightly claims that A should pay because the risk had passed to A under IV.A.–5:102 when the china was handed over.

It does not matter whether the goods have been lost or damaged completely or merely partially. Thus, the buyer has to pay the full price, provided that the risk has passed. It is a different question altogether whether the seller is discharged from the obligation to

deliver, or still has to deliver what is left (see III.–3:104 (Excuse due to an impediment) and III.–3:302 (Non-monetary obligations) paragraph (3)(b) and Comment C below).

C. Different types of risk in sales

On the other hand, it can be asked whether the seller still has to deliver in spite of the impediments to performance, i.e. the fact that the goods have either perished or been damaged. This aspect of risk relating to the seller is called the risk of performance, which is already covered by III.–3:104 (Excuse due to an impediment). If the risk has passed, the buyer must pay but the seller is excused from the obligation to deliver the goods. If the risk has not passed, the seller is either excused or must deliver other goods. The question is whether the case is one of excused non-performance - which depends on whether it is possible to perform the obligation under the contract. This in turn is likely to depend on whether the contract was one for the sale of those specific goods, of goods from a specified bulk (which cannot be transferred if the bulk has been destroyed) or of generic goods.

Illustration 2

A, a retailer, sells the remaining TVs of an older model already out of production in bulk to B, a small shop owner, who wants to resell them at low cost. At the time of the conclusion of the contract, it is clear that the TVs are all stored in a specific warehouse. However, the TVs are lost in a fire that burned down the warehouse where A had stored them. A is excused from delivering the TVs, and paying damages to B, since the non-performance is excused under III.–3:104 (Excuse due to an impediment). It would have been different if the contract required the seller to deliver generic goods, i.e. a TV of a model still in production which can readily be obtained from another source.

Illustration 3

The facts are the same as in illustration 2. If the seller is to blame for the fire, say one of his employees had dropped a lighted cigarette, he is liable to the buyer in damages.

Lastly, the present rules also address another important aspect of risk, that of lack of conformity. Technically speaking, the question of who is liable for defective goods does not fall under the classical notion of risk in sales law (i.e. the accidental demise of, or damage to, goods before the actual handing over). However, these two concepts can, at times, conflict with each other, see IV.A.–5:102 (Time when risk passes) Comment C.

D. Act and omission of the seller

The rules on the passing of risk come into play only in the case of fortuitous events resulting in the loss of or damage to the goods, i.e. events that neither party could foresee. The present Article reflects this important principle by providing for an exception relating to the seller's conduct. If the seller is responsible for the loss of or damage to the goods, the buyer is not deprived of rights against the seller regarding that loss or damage.

Illustration 4

The facts are the same as in illustration 1. After the contract is concluded it is agreed that B is to arrange for transportation of the china to A's place of business. B engages an independent carrier to transport the goods. During the transportation the china is totally destroyed since B has packed it in an insufficient manner. Even though the risk passed under IV.A.–5:202 (Carriage of the goods) paragraph (2) with the handing over to the carrier, A is not obliged to pay the price, since the damage was caused by B's actions.

As a rule, the seller will be liable in contract or under the law on non-contractual liability for damage for the act or omission resulting in the loss of, or damage to, the goods. The seller will be liable for acts and omissions by persons for whom the seller is responsible, e.g. employees (for the relationship with the rules on lack of conformity, see IV.A.–5:102 (Time when risk passes) Comment D below).

IV.A.–5:102: Time when risk passes

(1) The risk passes when the buyer takes over the goods or the documents representing them.

(2) However, if the contract relates to goods not then identified, the risk does not pass to the buyer until the goods are clearly identified to the contract, whether by markings on the goods, by shipping documents, by notice given to the buyer or otherwise.

(3) The rule in paragraph (1) is subject to the Articles in Section 2 of this Chapter.

COMMENTS

A. General

This Article contains the main rule of the passing of risk, i.e. that the risk passes when the buyer takes over the goods or documents representing them. Paragraph (2) sets out an important requirement for the passing of risk: as long as goods have not been clearly identified to the contract of sale, risk cannot pass. Put differently, the loss of or damage to goods not clearly identified always rests with the seller. The buyer can therefore still request the delivery of new goods without having to pay the price of the lost or damaged goods. Lastly, paragraph (3) makes clear that the general rule on the passing of risk is subject to several exceptions in Section 2, IV.A.–5:201: (Goods placed at the buyer's disposal), IV.A.–5:202: (Carriage of the goods) and IV.A.–5:203: (Goods sold in transit).

Since the provisions on the allocation of risk are, by and large, default rules (see IV.A.–1:301 (Rules not mandatory unless otherwise stated)), the parties are free to agree otherwise. In particular, the parties may agree that the risk passes earlier, e.g. retrospectively or upon the conclusion of the contract, or after taking over the goods. The parties may also provide separately for specific types of risk.

B. The main rule: taking over the goods or documents

As a rule, the risk of the loss of or damage to the goods passes from the seller to the buyer when the buyer takes over the goods or the documents representing them. Thus, there is a link between control over the goods, either physically or indirectly (i.e. by means of the documents representing them), and the allocation of risk. At the same time, this rule in paragraph (1) corresponds to IV.A.–3:301 (Taking delivery) sub-paragraph (b), which obliges the buyer to take delivery by actually taking over the goods or documents representing the goods.

This taking-over rule is justified for various reasons. To start with, any owner of goods assumes the risk that they may perish accidentally. Since it is the party with physical control over the goods who is in the best position to protect them from damage, this party also assumes that risk prior to the performance of a sales contract. Besides, the party in possession of the goods is in the best position to insure them.

The link between the passing of risk and the taking over of the goods, or the documents representing them, is of particular significance when, in the course of a sales transaction, ownership and control over the goods are separated. If, for instance, a sales contract contains a retention of title clause, ownership of the goods remains with the seller until the buyer pays the price, although risk is transferred to the buyer from the time the goods are taken over.

C. Lack of conformity and rules on the passing of risk

While it has been pointed out that the rules on risk are, at least from a technical point of view, distinct from those relating to lack of conformity (see IV.A.–5:101 Comment B), it cannot be overlooked that there is a certain interdependency.

According to IV.A.–2:308 (Relevant time for establishing conformity) paragraph (1), the seller is liable for any lack of conformity which exists at the time when the risk passes to the buyer, even though the lack of conformity only becomes apparent after that time. The passing of the risk is here the decisive moment for assessing whether there is a lack of conformity. If there is a lack of conformity at the time when the risk normally passes to the buyer, the seller's liability does not pass to the buyer, thus the rules on non-conformity override the risk provisions. Nevertheless, a complicated situation might arise if the risk passes before the goods actually come into the buyer's possession, especially when they are delivered to the first carrier in accordance with IV.A.–5:202 (Carriage of the goods) paragraph (2). In such cases it may for instance be difficult to assess if the goods were damaged during transportation, or if they were already not in conformity at the time when the risk passed (that is when the goods were delivered to the carrier). In the former case, the seller would not be liable for the damage in accordance with IV.A.–5:202(2), whereas in the latter case the seller would be responsible according to the provisions on non-conformity.

Illustration 1

A, a shop owner, and B, a retailer, conclude a contract for the sale of 20 boxes of china and contract that the goods will be transported by an independent carrier to A's shop. While unpacking the goods A notices that the china is damaged in five of the boxes. In this case, the damage could have been in existence before the goods were handed over to the carrier, but it could also have occurred during transportation.

D. Identification of the goods

Paragraph (2) reflects a central property law principle, i.e. that of specificity, which is also of importance for the passing of risk. In practice, this requirement of identification is of particular relevance for the passing of risk in sales involving carriage under IV.A.–5:202 (Carriage of the goods). This is one reason why IV.A.–2:204 (Carriage of the goods) paragraph (2) obliges the seller to give the buyer notice of consignment in the case of the carriage of the goods).

Goods may be identified to a contract of sale in several ways. Separation, marking and packaging of the goods are the most obvious; the importance of identification in the context of carriage has already been stressed in IV.A.–2:204 (Carriage of the goods) paragraph (2). Whether goods have been duly identified to the contract before they were lost or damaged will often be a question of proof, especially when it cannot be established when the event causing the loss or damage occurred.

Illustration 2

A purchases from B, a wholesale distributor, 20 TVs in order to furnish the rooms of his small country hotel. The parties agree that A is to pick up the goods on March 25. Generally, the risk would pass at that date according to IV.A.–5:201 (Goods placed at buyer's disposal) paragraph (1). However, if B has not separated A's order from the same type of TVs in his warehouse, the risk will not pass until he does so.

Identification of the goods can take place as soon as the contract is made. However, goods may often not be identified to the sales contract until the seller tenders delivery to the buyer. The significance of this late identification, as it were, becomes apparent in two situations. First, risk passes to the buyer as a consequence of the delay in taking over the goods, given that the seller has actually tendered the goods at the right place and time (IV.A.–5:201 (Goods placed at the buyer's disposal)). Secondly, if goods are transported in bulk the risk does not pass before the seller has notified the buyer of the consignment (see IV.A.–5:202 (Carriage of the goods)).

Illustration 3

The facts are the same as in illustration 2. A fails to pick up the goods at the agreed time. On March 28 B's warehouse is destroyed by fire overnight. Generally, the risk would have passed on March 25 according to IV.A.–5:201 (1).

However, if B has not separated A's order from the same type of TVs in the warehouse, the risk has not passed according to this provision and A can require the delivery of new goods.

E. Exceptions

The general rule of this Article is subject to a number of exceptions, which are addressed in Section 2: IV.A.–5:201 (Goods placed at the buyer's disposal) addresses cases of *mora creditoris*; while IV.A.–5:202 (Carriage of the goods) and IV.A.–5:203 (Goods sold in transit) set out rules relating to the risk in the event of the transportation of the goods.

IV.A.–5:103: Passing of risk in a consumer contract for sale

(1) In a consumer contract for sale, the risk does not pass until the buyer takes over the goods.

(2) Paragraph (1) does not apply if the buyer has failed to perform the obligation to take over the goods and the non-performance is not excused under III.–3:104 (Excuse due to an impediment) in which case IV.A.–5:201 (Goods placed at buyer's disposal) applies.

(3) Except in so far as provided in the preceding paragraph, Section 2 of this Chapter does not apply to a consumer contract for sale.

(4) The parties may not, to the detriment of the consumer, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General

This Article contains an important exception for consumer contracts for sale from the main rule in IV.A.–5:102 (Time when risk passes) and the special rules in Section 2, as risk does not pass before the buyer actually takes over the goods. This means, for example, that the risk does not pass upon the mere transfer of documents representing the goods. There is an exception to this rule for consumers if the consumer buyer has failed to perform the obligation to take over the goods and this non-performance is not excused (paragraph (2)). Paragraph (3) contains a general clarification that the provisions in Section 2 do not apply under a consumer contract for sale.

Basically, the aim of the rule is to avoid burdening the consumer unduly with unforeseen risks, which he or she will neither be able to anticipate nor be likely to have taken out insurance against. This provision goes beyond the scope of the Consumer Sales Directive, where the matter of risk is explicitly not dealt with. Due to the importance of this principle to the consumer and the high risk that sellers would contract out of it through standard terms, this provision is mandatory in favour of the consumer (paragraph (4)).

B. Goods placed at the consumer's disposal

Under the general regulation, normally if the buyer delays in taking over the goods, the risk will pass to the buyer from the time when the goods should have been taken over, provided that the buyer was aware that the goods were available for collection (IV.A.–5:201 (Goods placed at buyer's disposal) paragraph (1)). The present Article modifies this rule for consumer contracts for sale by establishing that the risk does not pass until the buyer actually takes over the goods, unless the buyer's failure to take over the goods is not excused under III.–3:104 (Excuse due to an impediment).

Illustration 1

A, a consumer buyer, has bought a car from S, a car dealer. The parties agree on a certain date when A is to pick up the car from the seller's place of business. A does not remember the appointment and fails to pick up the car on the agreed date. During that same night, the car is stolen from the seller's premises. The risk is on the buyer, since the failure was not excused.

Illustration 2

The facts are the same as above. On the agreed date A is on his way to pick up the car when he has a traffic accident and ends up in hospital with severe injuries. When the car is stolen, the risk rests with the seller, since A's failure is excused under III.–3:104 (Excuse due to an impediment).

The modification for consumers is even more important in respect of IV.A.–5:201 (Goods placed at buyer's disposal) paragraph (2), which addresses cases where the seller makes the goods available at a place other than his place of business. Even though no failure to take over the goods is required, the present Article introduces such a requirement in paragraph (2).

C. Carriage of goods in a consumer contract for sale and passing of risk

Under the general regulation where carriage of goods is involved, the main rule in IV.A.–5:202 (Carriage of the goods) paragraph (2) is that the risk passes when the goods are handed over to the carrier. In a consumer contract for sale, however, risk only passes when the goods are actually handed over to the buyer. As a consequence, if the consumer does not receive the goods because these have been lost or destroyed, he or she does not have to pay for them. Moreover, the seller is delaying in the delivery and all remedies for delay are therefore available.

Illustration 3

A, a consumer, buys a fridge just across the border of his native country. According to the agreement, the seller will take care of the transportation of the fridge to A's residence. The seller charges a cross-border delivery service for the transportation. However, the lorry carrying, amongst other goods, the fridge for A, is involved in a traffic accident, in which all the goods are damaged beyond

use. Since A has not yet taken over the goods, the risk does not pass. As the risk was still with the seller, he is in delay when not delivering the fridge to A on time.

Such a result will provide an incentive for the seller to exercise the utmost care in arranging transportation and in choosing a carrier. The seller will also be in a better position to calculate the price by integrating the economic cost of the transportation risks in long-term financial arrangements or to obtain a favourable insurance, which often may be blanket cover. A consumer, on the other hand, would encounter more obstacles in pursuing claims against third parties or in pressing an insurance claim. Lastly, it should be pointed out that in many cases a seller involved in consumer transactions will operate its own fleet of delivery vehicles. If so, according to the general rule the risk does not pass anyway before the goods are taken over by the consumer.

Section 2: Special rules

IV.A.–5:201: Goods placed at buyer's disposal

(1) If the goods are placed at the buyer's disposal and the buyer is aware of this, the risk passes to the buyer from the time when the goods should have been taken over, unless the buyer was entitled to withhold taking of delivery under III.–3:401 (Right to withhold performance of reciprocal obligation).

(2) If the goods are placed at the buyer's disposal at a place other than a place of business of the seller, the risk passes when delivery is due and the buyer is aware of the fact that the goods are placed at the buyer's disposal at that place.

COMMENTS

A. General

This Article provides an exception to the main rule of IV.A.–5:102 (Time when risk passes) according to which the risk passes when the buyer takes over the goods. Under this Article, in a non-consumer contract for sale the risk passes when the goods are made available to the buyer and the buyer fails to take over the goods. The starting point is that the buyer is obliged to take over the goods under the contract. If the buyer fails to comply with this obligation, the risk passes subject to certain conditions.

Paragraph (1) applies to cases where the buyer has to pick up the goods at the seller's place of business. In this case, the risk passes only if the buyer is aware of the goods being available for collection and still fails to pick them up in breach of an obligation under the contract.

Paragraph (2) works as a catch-all clause for all other cases (i.e. the seller has to deliver the goods to the buyer or the buyer has to pick up the goods from another place such as a

warehouse). In this case, the risk passes at the time when the goods are placed at the buyer's disposal, provided that the buyer is aware of the goods being so placed.

B. Goods made available at the seller's place of business

The risk passes to the buyer under paragraph (1) if three conditions are met. First, the goods have been placed at the buyer's disposal at the seller's place of business. Thus, the buyer is supposed to pick up the goods from the seller, which is also the default rule of IV.A.-2:202 (Place and time for delivery). Secondly, the seller has to actually make the goods available to the buyer, that is must tender the goods as agreed in the contract. In particular, this requires the identification of the goods within the meaning of IV.A.-5:102 (Time when risk passes) paragraph (2). And, thirdly, the buyer must have failed to take delivery as required by the contract.

Not only does this rule prevent the buyer from postponing the passing of the risk by not taking delivery from the seller (the so-called *mora creditoris*), but it also sanctions the buyer for having frustrated the seller's attempt to perform the obligation to deliver. While the seller can, in principle, force the buyer to take over the goods, in practice the normally preferred remedy would be to sue the buyer for the price. The passing of risk in such a situation provides a further incentive for the buyer to take over the goods, since the full price will be payable even if the goods are lost or damaged during the period of the delay.

It is fair to absolve the seller from the risk that the goods may perish accidentally if the seller has attempted to comply with the obligations under the contract. As just pointed out, this consequence also serves as an additional incentive for the buyer to comply with the obligation to take delivery. In fact, the buyer may suffer a triple detriment upon the failure to take over goods that are subsequently accidentally lost or damaged: loss of the goods; payment of the price; and a possible liability in damages for breach of contract (if non-performance of the obligation to take delivery has caused the seller any incidental loss).

C. Goods made available at a place other than the seller's place of business

If the seller has to make the goods available at a place other than the seller's place of business the risk passes to the buyer when delivery is due. However, the passing of risk in this case is subject to two conditions. First, the seller has to make the goods available to the buyer (see Comment B above). Secondly, the buyer must be aware of this place of performance and the fact that the goods are made available there. *Mora creditoris* is, however, not required for the passing of risk. In other words, it is irrelevant whether the buyer, by failing to take over the goods, fails to perform an obligation under the contract.

Illustration 1

A, a retailer, sells goods to B. They agree that the goods will be made available to B at a certain date directly at the place of production, a factory, which is close to

B's place of business. The risk passes on the agreed date, given that A has informed B that the goods have been made available at the factory.

In sum, paragraph (2) constitutes a catch-all clause for the passing of risk when goods are placed at the buyer's disposal at any place other than the seller's place of business. It therefore covers both cases where the seller has to deliver the goods to the buyer, and cases where the buyer has to pick up the goods from another place, such as a warehouse or a factory. However, it does not apply in the situations involving transportation covered by IV.A.–5:202 (Carriage of the goods) and IV.A.–5:203 (Goods sold in transit).

D. Consumer contract for sale

This Article does not apply to consumer contracts for sale except to the extent provided for in IV.A.–5:103 (Passing of risk in a consumer contract for sale) paragraph (2) – that is, where the consumer buyer has failed to perform the obligation to take over the goods and that failure is not excused. See the Comments to that Article.

IV.A.–5:202: Carriage of the goods

(1) This Article applies to any contract of sale which involves carriage of goods.

(2) If the seller is not bound to hand over the goods at a particular place, the risk passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer in accordance with the contract.

(3) If the seller is bound to hand over the goods to a carrier at a particular place, the risk does not pass to the buyer until the goods are handed over to the carrier at that place.

(4) The fact that the seller is authorised to retain documents controlling the disposition of the goods does not affect the passing of the risk.

COMMENTS

A. General

This Article deals with the passing of risk in the event of the carriage of the goods. Basically, the risk passes to the buyer when the goods are handed over to the carrier, and not, as required by the main rule of IV.A.–5:102 (Time when risk passes), when the buyer takes over the goods.

This provision has to be read in the light of the rules on carriage contained in Chapter 2, Section 2. According to IV.A.–2:201 (Delivery) paragraph (2), the seller delivers by handing over the goods to the carrier, and by transferring to the buyer any document which is necessary to take over the goods from the carrier; in addition, IV.A.–2:204 (Carriage of the goods) sets out several obligations on the part of the seller in relation to the carriage of the goods.

B. Carriage of the goods and passing of the risk

Under a sales contract involving the carriage of goods from the seller to the buyer, the risk generally passes when the seller hands over the goods to the carrier, and not when the buyer eventually receives the goods. If the parties have not agreed on a particular place for handing over the goods (paragraph (2)), the risk passes upon handing over the goods to the first independent carrier. In general, the goods will be deemed to have been handed over for transportation when the goods have been placed at the carrier's area of control.

Illustration 1

A sells ten computers to B. The parties agree that A is to arrange for the transportation of the goods to B's place of business. A engages an independent carrier to transport the goods. The risk passes when the goods are handed over to the carrier.

If, however, the seller has to hand over the goods at a particular place (paragraph (3)), the risk passes when the goods are handed over to the carrier at that place. This is generally only the case if the buyer is supposed to organise the transportation. The buyer may then, for instance, name an airport or a port where the goods are to be handed over to the carrier. As a consequence, if the seller hands over the goods to the carrier at the wrong place the risk will not pass.

Illustration 2

The facts are the same as under illustration 1. The parties agree that the seller is to hand over the goods to the carrier, an international logistic company at a certain airport. Due to a mistake, A delivers the goods to the carrier at the domestic airport, instead of at the international airport as agreed. Since A has not complied with the requirements under paragraph (3) of this provision, the risk has not passed.

The rule that the risk passes when goods are handed over to the carrier forms an exception to the main rule, according to which the risk passes when the buyer takes over the goods. It is based upon the idea that the risk in general should pass when the seller has done everything possible to deliver the goods. It is also based on the assumption that the carriage of the goods is for the buyer's benefit. It is also customary in international trade to consider the carrier as an 'extension' of the buyer. The rule is not justified in terms of control, because after delivery to the carrier neither the seller nor the buyer has physical control of the goods. On the contrary, in practice after dispatch the seller will usually be the party who can control the goods, or at least the disposition of the goods. It should be pointed out, however, that if the goods are damaged in transit, the buyer may have a claim against the carrier; and that normally the buyer will have the benefit of insurance cover. The buyer will either arrange this directly (e.g. in an FOB contract) or the seller will be obliged to arrange it on the buyer's behalf (as is the case under a CIF contract).

Paragraph (4) makes it clear that the fact that the seller is authorised to retain documents controlling the disposition of the goods does not affect the passing of the risk. It is of no consequence which party is in possession of the documents; the actual handing over to the carrier is the decisive element. Questions as to the transfer of ownership, such as those arising from retention of ownership clauses, are also unimportant for the passing of the risk.

This provision only applies if the parties have not agreed otherwise. The parties are free to regulate the matter of risk as they wish, for instance by agreeing that the risk is not to pass until the goods are actually taken over by the buyer.

C. The carrier as an independent entity from the seller

The carrier envisaged in the first paragraph is an independent carrier. Whether a freight forwarder should also be included under the notion of a carrier may be uncertain, due to the different roles which a freight forwarder plays. However, in cases where the goods are taken by a freight forwarder with the purpose of having the goods transferred to the buyer, this rule does apply. If the seller undertakes the transportation without using an independent carrier the risk will not pass until goods have been handed over to the buyer.

Illustration 3

A buys construction materials from Z, a large manufacturer of red bricks. The parties agree that one of Z's employees will bring the materials to A's building site. In this case the risk will not pass until the material is delivered to the building site.

D. Consumer contract for sale

See the Comments to IV.A.-5:103 (Passing of risk in a consumer contract for sale).

IV.A.-5:203: Goods sold in transit

- (1) This Article applies to any contract of sale which involves goods sold in transit.*
- (2) The risk passes to the buyer at the time the goods are handed over to the first carrier. However, if the circumstances so indicate, the risk passes to the buyer as from the time of the conclusion of the contract.*
- (3) If at the time of the conclusion of the contract the seller knew or could reasonably be expected to have known that the goods had been lost or damaged and did not disclose this to the buyer, the loss or damage is at the risk of the seller.*

COMMENTS

A. General

This Article applies to the sale of goods in transit, that is goods that are already travelling from point of departure to their destination.

Illustration 1

A buys 100 barrels of cotton from B. B dispatches the goods to A. While the goods are still in transit A sells the goods to C. The latter bears the risk for the damage from the time of the delivery to the carrier.

B. Sale of goods in transit and the passing of risk

As a rule, the risk in the case of a sale of goods in transit passes from the time the goods are handed over to the first carrier. Therefore the buyer of goods in transit assumes the risk for a time before the conclusion of the sales contract. This retrospective effect can be justified as follows. First, it is customary practice in this kind of commercial transaction that the final buyer undertakes the whole transportation risk, usually by taking out insurance. Secondly, this type of sale is based on documents representing or relating to the goods, such as insurance and disposition documents, which the buyer may examine before entering into the contract of sale.

The rule in article 68 of the CISG is as follows.

The risk in respect of goods sold in transit passes to the buyer from the time of the conclusion of the contract. However, if the circumstances so indicate, the risk is assumed by the buyer from the time the goods were handed over to the carrier who issued the documents embodying the contract of carriage. Nevertheless, if at the time of the conclusion of the contract of sale the seller knew or ought to have known that the goods had been lost or damaged and did not disclose this to the buyer, the loss or damage is at the risk of the seller.

The present Article uses the same ingredients but brings the solution of the CISG into line with commercial practice by making the exception of the first sentence of Article 68 CISG the rule. The risk may, however, still pass upon the conclusion of the contract if the circumstances so indicate, for example in the absence of insurance against transportation risks.

C. Exception

The main rule in paragraph (2) does not apply if the seller of the goods in transit knew, or should have known, that the goods have been lost or damaged on their journey and did not inform the subsequent buyer. In such a case the seller is in bad faith and must bear that particular risk.

Illustration 2

The facts are the same as in illustration 1. When the cotton arrives at the port of destination C discovers that during the voyage part of the cotton has been damaged. Normally this loss is borne by C, who may seek to press an insurance claim. If A, when entering into the contract of sale with C, knew or ought to have known that the cotton was damaged and did not disclose that information to C, then that loss is borne by A.

D. Consumer contract for sale

Since such sales transactions are almost exclusively commercial transactions, consumer contracts for sale

CHAPTER 6: CONSUMER GOODS GUARANTEES

IV.A.–6:101: Definition of a consumer goods guarantee

(1) A consumer goods guarantee means any undertaking of a type mentioned in the following paragraph given to a consumer in connection with a consumer contract for the sale of goods:

- (a) by a producer or a person in later links of the business chain; or*
- (b) by the seller in addition to the seller's obligations as seller of the goods.*

(2) The undertaking may be that:

- (a) apart from misuse, mistreatment or accident the goods will remain fit for their ordinary purpose for a specified period of time, or otherwise;*
- (b) the goods will meet the specifications set out in the guarantee document or in associated advertising; or*
- (c) subject to any conditions stated in the guarantee,*
 - (i) the goods will be repaired or replaced;*
 - (ii) the price paid for the goods will be reimbursed in whole or in part; or*
 - (iii) some other remedy will be provided.*

COMMENTS

A. General

This Article provides the definition of a 'consumer goods guarantee'. The first paragraph indicates who may be the provider and recipient of the guarantee. The second paragraph lists different variants, or basic examples, of consumer goods guarantees by describing what a consumer goods guarantee may actually contain.

The application of the rules contained in Chapter 6 is limited to consumer contracts for sale, as they were specifically designed to answer the needs of consumer contracts for sale. The main reason for this policy choice lies in the specific function that the guarantee

plays in relation to consumer contracts for sale, which is distinct from the function assumed in other categories of sales. Under commercial sales a guarantee by the producer is often coupled with a reduction of the buyer's rights against the seller. Consumer contracts for sale, on the other hand, are to a large extent governed by rules of a mandatory character, and the guarantee cannot influence (in a negative way) the rights of the buyer. At the same time, guarantees, used as marketing tools aiming at tying the consumer to a particular brand, may very often mislead the consumer as to his or her actual rights. This may lead to a situation where, instead of improving the position of the consumer, a guarantee actually impairs it.

B. Choice of terminology

In the first place, the term 'consumer goods guarantee' refers to the object of the transaction, which has two consequences. On the one hand, it indicates the boundaries of this Chapter by linking the guarantee both to consumers and goods. In this context, it should be noted that the present rules, while defining 'goods' in Annex 1 and IV.A.–1:201 (Goods), do not provide specific rules for consumer goods. However, the rules in the present Chapter are applicable to goods sold in the course of a consumer contract for sale, as defined in IV.A.–1:204 (Consumer contract for sale).

Next, defining the guarantee by reference to the object of the transaction indicates a very strong connection between the guarantee and the object that it accompanies. This is reconfirmed by IV.A.–6:102 (Binding nature of the guarantee) paragraph (2), which establishes that, as a default rule, the guarantee is attached to, and thus follows, the consumer goods.

C. Undertaking

The present rules do not take a stand with respect to the legal form of the consumer goods guarantee. In this respect, they follow the approach adopted by the Consumer Sales Directive, which also uses the expression of 'undertaking', without defining its meaning. The legal qualification of the consumer goods guarantee may depend on many factors, the most important being the will of the party who offers a consumer goods guarantee. Depending on the situation, a guarantee may take the form of a contract, a contractual clause or a unilateral promise. While the legal qualification of the guarantee is of the utmost importance, defining it may have an undesired, restrictive result.

Accordingly, the choice of the legal form of the consumer goods guarantee is left to the parties. If the parties do not make that choice explicitly, the legal form should be established by means of interpretation.

D. Parties related to the consumer goods guarantee

The first consumer buyer of the goods furnished with the consumer goods guarantee always obtains the status of the guarantee holder, and is thus able to invoke the consumer goods guarantee. As a default rule under IV.A.–6:102 (Binding nature of the guarantee), the consumer goods guarantee is attached to the goods. Therefore every subsequent owner of the goods is also entitled to invoke it.

The consumer goods guarantee may be provided by the seller, by the producer, or by any other person in later links in the business chain (which reflects the wording of IV.A.–2:303 (Statements by third parties)). The position of a seller and a producer offering a guarantee is different, as the seller is already bound under the conformity regime. If the seller decides to offer a guarantee it is an undertaking additional to the obligations arising from the conformity requirements, whereas a guarantee by the producer is self-standing. According to IV.A.–6:102 (Binding nature of the guarantee), the question of who is the guarantor does not affect the binding nature of the consumer goods guarantee. The wording of the present Article highlights the distinct nature of the consumer goods guarantee provided by the seller and of that provided by the producer (or any other person in later links in the business chain); but at the same time, it allows for an effective and refined common regulation throughout Chapter 6.

In practice, the most common guarantees will be those provided by the producers and the sellers of the goods. However, there is no reason for limiting the number of prospective guarantors, since including other possible guarantors makes the regulation more effective and responsive to market realities.

E. The content of the consumer goods guarantee

Paragraph (2) indicates various variants, or basic examples, of consumer goods guarantees and their contents. Under paragraph (1) the guarantee need only be of a type mentioned in paragraph (2). There may, of course, be many different versions of guarantees falling within these types and the third type concludes with the general expression: “some other remedy will be provided”. To this extent the variants in paragraph (2) leave room for expansion.

Sub-paragraph (a) presents the most neutral of the three variants. In this context, the guarantor promises what the consumer is already entitled to expect under the conformity regime set out in Chapter 2, Section 3. In other words, the ordinary purpose is that referred to in IV.A.–2:302 (Fitness for purpose, qualities, packaging) sub-paragraph (b). The goods should be fit for their ordinary purpose for a specified period of time. The guarantor may specify the period of time; otherwise, the default period laid down in IV.A.–6:104 (Coverage of the guarantee) applies.

Sub-paragraph (b) mirrors the definition of the guarantee established by the Consumer Sales Directive. This is the most common solution in consumer contracts for sale; it assumes that the guarantor establishes certain specifications with regard to the goods, either in the guarantee itself or in the associated advertising. The content of the consumer goods guarantee is determined by the guarantee document and the associated advertisement jointly (see also Comment F below). The guarantor is free to make these specifications, subject to certain transparency conditions under IV.A.–6:103 (Guarantee document). The most common elements that should be covered by the specifications of the guarantor are listed in IV.A.–6:104 (Coverage of the guarantee). The default

specifications in this latter provision apply if, and to the extent that, the guarantor fails to specify what is covered by the guarantee offered.

In contrast to the two previous variants, sub-paragraph (c) approaches the consumer goods guarantee from a remedial perspective. The remedies include repair, replacement, reimbursement of the purchase price in whole or in part, as well as other possible remedies (which reflects the solution adopted by the Consumer Sales Directive). The concluding words mean that the list does not lay down any limits for the guarantor in relation to the potential remedies. The guarantor may provide one or all of the listed remedies, a remedy different from those listed under sub-paragraph (c), or indeed a combination of the listed remedies. If the guarantor does not indicate which remedies are available to the guarantee holder or who is entitled to choose a remedy, the guarantee holder may choose between repair, replacement, or reimbursement of the price paid (see IV.A.–6:104 (Coverage of the guarantee) and cf. also Comment D to that Article). If the guarantor offers the guarantee holder certain remedies, the transparency requirements of IV.A.–6:103 (Guarantee document) have to be observed in any case.

F. Associated advertising

As indicated in paragraph (2)(b), the actual scope and content of the consumer goods guarantee may be determined by the conditions set out both in the guarantee document and in the associated advertising. Statements in advertising may contain promises that amount to guarantees (e.g. “Guaranteed for five years”) but a mere statement of fact (“This car will do 35km to the litre”) does not by itself amount to a guarantee. If the consumer goods guarantee is determined exclusively by advertising, the same rules apply as in the case of a regular guarantee (assessment of the guarantee content in accordance with default rules, the right of the consumer to request a guarantee document, etc.).

Where the guarantee document and the associated advertising are equally important in determining the content of the guarantee, possible discrepancies between them should be solved through the interpretation which is the most favourable to the consumer in the given circumstances (cf. II.–8:103 (Interpretation against party supplying term)).

G. Consumer goods guarantee free of charge and against payment

The definition of the Consumer Sales Directive indicates that the guarantee must be provided free of charge. In fact, this means that the price of the guarantee should be included in the purchase price. Since the Directive does not apply to guarantees that are offered against direct payment (‘given without extra charge’) a significant (and growing) number of guarantees offered to consumers remain outside the scope of its influence. At the same time, the Directive limits this restriction only to the offering of the guarantee. It therefore gives the guarantor the possibility to impose two other types of costs on consumers: the cost of invoking and that of performing the guarantee (cf. IV.A.–6:104 (Coverage of the guarantee) sub-paragraph (d)). In addition, the exclusion of guarantees against payment offers guarantors a very easy route to escape the application of the rules of the Directive, for example by charging a trifling sum for the guarantee.

Market practice shows that guarantors very often offer instruments called ‘extended guarantees’ or ‘insurance policies’ with respect to the goods sold that in fact constitute guarantees provided against payment. Another common practice is for the guarantor to offer a free guarantee for a relatively short period of time and to invite the consumer to pay extra in order to have it prolonged.

For these reasons, the present rules do not differentiate between guarantees that are, or appear to be, free of charge, and guarantees against extra payment. However, if the guarantor decides to offer a consumer goods guarantee that imposes any kind of liability for direct payment on the consumer, this must be clearly communicated to the consumer (see IV.A.–6:104 (Coverage of the guarantee) sub-paragraph (d)). If the guarantor remains silent as to the costs related to the guarantee, there is a presumption that the costs for the guarantee are included in the purchase price and that there are no additional payments relating to it.

IV.A.–6:102: Binding nature of the guarantee

(1) A consumer goods guarantee, whether contractual or in the form of a unilateral undertaking, is binding in favour of the first buyer, and in the case of a unilateral undertaking is so binding without acceptance notwithstanding any provision to the contrary in the guarantee document or the associated advertising.

(2) If not otherwise provided in the guarantee document, the guarantee is also binding without acceptance in favour of every owner of the goods within the duration of the guarantee.

(3) Any requirement in the guarantee whereby it is conditional on the fulfilment by the guarantee holder of any formal requirement, such as registration or notification of purchase, is not binding on the consumer.

COMMENTS

A. General

Once the guarantor has decided to furnish goods with a consumer goods guarantee and the goods are sold to the consumer, the guarantee becomes binding. This rule applies irrespective of the legal form in which the consumer goods guarantee is offered to the consumer. A consumer goods guarantee has been defined in the preceding Article as an “undertaking”. The undertaking may be contractual. It may be given by the seller as part of the contract for sale of the goods (which will then technically be a mixed contract for sale and guarantee) or it may be given in a separate contract. Such a separate contract may be one in which the seller gives an “extended guarantee” in exchange for an additional payment or it may be a similar contract with the producer or another guarantee provider (the seller acting as the guarantor’s representative in concluding the contract). In such cases the buyer’s acceptance will have been given, either to the contract for sale or to the separate guarantee contract. Very commonly, however, the undertaking will be a

unilateral undertaking by the producer. In such a case the undertaking, if intended to be legally binding without acceptance, will be so binding in accordance with the general rules in Book II (see II.–1:103 (Binding effect) paragraph (2)). Paragraph (1) of the present Article strengthens this normal rule. Something which purports to be a unilateral guarantee will be binding without acceptance notwithstanding any provisions to the contrary made in the guarantee document or in the associated advertising. In effect, a person who gives a unilateral undertaking within the definition of a consumer goods guarantee is conclusively presumed to intend it to be legally binding without acceptance. Paragraph (1) of this Article constitutes one of the few mandatory provisions on consumer goods guarantees in this Chapter.

B. Transferability of the consumer goods guarantee

As a default rule, the consumer goods guarantee is transferred to every subsequent owner of the goods for the remaining duration of the guarantee. The legal basis on which the subsequent owner receives the ownership of the goods is not relevant – it could be, for example, a sale, barter, gift or succession.

If the guarantor does not specify otherwise, the new owner of the goods obtains the rights arising from the consumer goods guarantee automatically. However, the guarantor is able to either limit the applicability of the consumer goods guarantee to the first buyer, or restrict its transferability. The restriction may, for instance, come in the form of a requirement to notify that the goods have been transferred, or a stricter requirement to obtain permission from the guarantor in order to transfer the consumer goods guarantee to another person.

This form of control may be irrelevant to many guarantors. Nevertheless, it is a highly sensitive area for guarantors offering guarantees based on the buyer's profile (e.g. whether the buyer of a car is 20 or 50 years of age). Therefore, it is important to grant the guarantor flexibility in this regard. In any case, the limitation must be expressly contained in the guarantee document in order to be valid.

C. Formal requirements

As clearly indicated in paragraph (1), the consumer goods guarantee is binding without acceptance. In addition, paragraph (3) establishes that the binding force of the consumer goods guarantee cannot be conditional on formal requirements being met. Any sort of formal requirements imposed by the guarantor on the buyer, such as registration and notification of the sale, do not influence the binding force of the guarantee, and cannot prevent it from entering into force.

Illustration 1

A buys a suitcase. He is informed by the seller that the suitcase is accompanied by a producer's guarantee and the guarantee document is stored inside the suitcase. A does not need to use the suitcase for the next two months. After that he finds out that the producer required the registration of the sale within 7 days after the purchase in order to activate the guarantee.

This provision is not intended to restrict guarantors from using devices like registration or notification, which can be useful for their own data gathering purposes. It only prohibits them from making the consumer goods guarantee conditional on the fulfilment of such requirements.

D. Relationship with Book II

It is already the case under Book II that a unilateral promise or undertaking can be binding without acceptance (see II.-1:103 (Binding effect) paragraph (2)). According to II.-4:301 (Requirements for a unilateral act) the promise or undertaking must be communicated to the promisee or to the public. In this respect, the present Article deviates from the rules in Book II, i.e. even if the buyer does not know about the existence of the product guarantee, it still binds the guarantor. This deviation is probably, however, more apparent than real because guarantees are used as selling points and in most cases the consumer will be told about the guarantee or it will be addressed to the public in advertisements or promotional literature.

IV.A.-6:103: Guarantee document

- (1) A person who gives a consumer goods guarantee must (unless such a document has already been provided to the buyer) provide the buyer with a guarantee document which:*
- (a) states that the buyer has legal rights which are not affected by the guarantee;*
 - (b) points out the advantages of the guarantee for the buyer in comparison with the conformity rules;*
 - (c) lists all the essential particulars necessary for making claims under the guarantee, notably:
 - the name and address of the guarantor;*
 - the name and address of the person to whom any notification is to be made and the procedure by which the notification is to be made;*
 - any territorial limitations to the guarantee; and**
 - (d) is drafted in plain, intelligible language; and*
 - (e) is drafted in the same language as that in which the goods were offered.*
- (2) The guarantee document must be in textual form on a durable medium and be available and accessible to the buyer.*
- (3) The validity of the guarantee is not affected by any failure to comply with paragraphs (1) and (2), and accordingly the guarantee holder can still rely on the guarantee and require it to be honoured.*
- (4) If the obligations under paragraphs (1) and (2) are not observed the guarantee holder may, without prejudice to any right to damages which may be available, require the guarantor to provide a guarantee document which conforms to those requirements.*
- (5) The parties may not, to the detriment of the consumer, exclude the application of this Article or derogate from or vary its effects.*

COMMENTS

A. General

This Article deals with the elements that enable the consumer to make use of the consumer goods guarantee in practice. The person who offers the guarantee is under an obligation to provide the consumer with a guarantee document, which meets the transparency requirements of this Article as to the content as well as to the presentation of the guarantee.

First of all, paragraph (1) aims at ensuring that the content of the guarantee is readily understandable (sub-paragraph (d)) and that its relation to the conformity regime is made clear (sub-paragraphs (a) and (b)). Moreover, it defines the information necessary to enable the consumer to make a claim against the guarantor (sub-paragraph (c)). Paragraph (2) regulates the form in which the guarantee is to be presented to the buyer. The remainder of the Article deals with the consequences of infringing the transparency requirements.

Due to the importance of this provision in order for the consumer to be able to invoke his or her rights, the Article is mandatory and may not be deviated from to the detriment of the consumer.

B. Consumer goods guarantee in relation to remedies for lack of conformity

In order to avoid situations where the guarantee misleads the consumer with regard to the remedies for lack of conformity, the Article introduces two requirements with respect to the content of the guarantee document. First, it has to inform the consumer that the buyer has legal rights for lack of conformity which are not affected by the guarantee (this is identical to Article 6(2) of the Consumer Sales Directive). Secondly, the guarantee document should indicate the advantages, if any, of the consumer goods guarantee as compared to the conformity regime. This may, for instance, be a more favourable regulation of the burden of proof of non-conformity (cf. IV.A.–2:308 (Relevant time for establishing time of conformity) paragraph (2) and IV.A.–6:107 (Burden of proof)).

These requirements will also discourage guarantors from providing guarantees with no additional, or even less, protection than provided under the conformity regime. Thus, these two elements should enable a correct assessment of the guarantee and its benefits to be made by the consumer.

C. Information necessary for making claims

In order to render the consumer goods guarantees effective, the guarantee document must contain all the information necessary to enable claims to be made under the guarantee. The list of elements required elaborates on the rules provided by the Consumer Sales Directive.

In particular, the present Article mentions the name and address of the guarantor, the name and address of the person to whom notification is to be made, and the procedure by which the notification is to be made. The guarantor is not obliged to remedy any non-conformity in the goods personally. However, the document has to indicate clearly to whom, where and how the failure of the goods should be notified. If notification is to be made to an entity other than the guarantor, the guarantee document must indicate the correct name and address.

D. Territorial limitations

The guarantor should inform the guarantee holder about the territorial scope of the guarantee, i.e. whether the guarantee can be invoked in a country other than the one in which the product was purchased (see paragraph (1)(b)(c)). This obligation is equally important in the case of local branches, where a given product is produced and sold only in a particular country and the consumer should know about the limitations related to this fact, as well as in the case of multinational chains of distribution. The legal form under which they function (not one multinational organisation, but chains of independent distributors) may render invoking the guarantee in a country other than the country of purchase impossible.

E. Language of the consumer goods guarantee

Paragraph (1)(d) refers to the intelligibility of the language used in the guarantee document. This is an elaborated version of Article 6(3) of the Consumer Sales Directive, which relates to the possibilities to read and understand the guarantee document. To that end, the language of the guarantee must be comprehensible to the average consumer (the plain and intelligible language requirement).

The Article does not reproduce Article 6(4) of the Consumer Sales Directive, whereby the Member States may require that the guarantee be drafted in one or more languages of the official languages of the Community. Moreover, these rules have refrained from introducing a requirement that the consumer may require a guarantee document in the same language as the goods were offered, since such a solution could cause many problems in practice.

Illustration 2

A Polish consumer on holiday in Ireland buys a hair-drier. All the assistants in the shop are Polish and therefore the transaction is concluded in Polish. In such a case it is not reasonable that the Irish producer of the hair-drier is obliged to predict such a situation and provide a guarantee in Polish.

F. The consumer goods guarantee document

Paragraph (2) requires the guarantee to be made available on paper or in another durable medium. This solution departs from the Consumer Sales Directive, which only requires that the guarantee is to be made available to the buyer upon request. The reasons for this deviation are very practical: first, the consumer would have to know about the right to

request the guarantee in order to exercise it; secondly, in the case of long-lasting goods accompanied by a long-term guarantee it is essential for the consumer to have a guarantee document, and third: attaching the guarantee to the goods is already a common practice.

Apart from the traditional paper guarantee, this includes a guarantee in an electronic form, i.e. sending the guarantee by email or publishing the guarantee on the Internet. In any case, the guarantee document must be available and accessible to the consumer.

G. Infringement of the content requirements

The mere fact that the guarantee document does not contain the required elements, or even that it is not made available to the consumer at all, does not affect the binding nature of the consumer goods guarantee. In such a case, the guarantee holder is entitled to specific performance and to damages.

Obtaining a guarantee document that adequately explains the content of the guarantee is essential to the consumer. Traditionally, the infringement of the guarantee transparency requirements was seen as a domain of public law, the Consumer Sales Directive being the best example of such an approach. Without proposing radical changes, these rules give the consumer a right to request a properly constructed guarantee document. The right to specific performance does not affect the right to damages for loss incurred as a result of the non-performance of the obligations under the Article (seeking legal assistance, translating the guarantee document, etc.).

IV.A.–6:104: Coverage of the guarantee

If the guarantee document does not specify otherwise:

- (a) the period of the guarantee is 5 years or the estimated life-span of the goods, whichever is shorter;*
- (b) the guarantor's obligations become effective if, for a reason other than misuse, mistreatment or accident, the goods at any time during the period of the guarantee become unfit for their ordinary purpose or cease to possess such qualities and performance capabilities as the guarantee holder may reasonably expect;*
- (c) the guarantor is obliged, if the conditions of the guarantee are satisfied, to repair or replace the goods; and*
- (d) all costs involved in invoking and performing the guarantee are to be borne by the guarantor.*

COMMENTS

A. General

This Article defines the default coverage of the consumer goods guarantee on the basis of certain aspects of the conformity regime. It deals with four essential elements of the content of the consumer goods guarantee: duration, the conditions of the guarantee, the guarantor's obligations and the costs of invoking and performing the guarantee. Not only

does this default content give assurance to the consumer, but it also stimulates activity on behalf of the guarantor who remains free to define the terms of the own guarantee in any other way.

As to the relation in general between the conformity regime and a consumer goods guarantee, the borderline between the two will not always be crystal clear. Generally, if the parties have agreed that the seller will undertake obligations towards the buyer additional to those under the contract for sale (or, where the guarantee is part of the same contract) additional to those under the sale part of the contract, then by definition the seller has given a consumer guarantee. Ultimately, this question will have to be decided by interpreting the terms of the guarantee.

B. Default coverage of the consumer goods guarantee

Duration of the consumer goods guarantee. If the guarantor does not specify the duration of the guarantee, the guarantee should be applicable for five years or the estimated life-span of the goods if that is shorter. The estimated life-span of the goods is to be established by means of interpretation. The elements that should be taken into account when making this assessment are the reasonable and justified expectations of the consumer, based on objective factors like the price of the goods and the reputation of the particular seller or producer.

Illustration 1

B, a consumer, buys an expensive sailing jacket. Upon purchasing the garment B received a 'lifetime guarantee' concerning the jacket. Eight years later B notifies the seller that the jacket is no longer waterproof, since the material on the shoulder parts has deteriorated. B requests repair or replacement under the guarantee. The retailer contests the claim stating that the guarantee should reasonably be valid for a period of 4-5 years, depending upon usage. However, since the guarantee granted is of a very far-reaching nature and for such an expensive jacket a longer life-span than stated by the retailer can be expected, the consumer is entitled to have the jacket repaired and made waterproof again.

Although this rule seems to grant the consumer very extensive rights, it should be kept in mind that it is merely a default rule. Besides, the overwhelming number of guarantees provided specify the duration of the guarantee; in fact, the duration often constitutes even the major element of the guarantee.

What triggers the guarantor's obligations? If the guarantee document does not provide otherwise the guarantor's obligations become effective if, for a reason other than misuse, mistreatment or accident, the goods at any time during the period of the guarantee become unfit for their ordinary purpose or cease to possess such qualities and performance capabilities as the guarantee holder may reasonably expect. The implied requirements under IV.A.-2:302 that the goods must be fit for a particular purpose and in conformity with samples or models are excluded as they would excessively burden the guarantor. In fact, they assume direct contact between the guarantor and the buyer.

Guarantor's obligations. If the guarantee document does not provide otherwise, subparagraph (c) provides that it includes an undertaking to repair or replace the goods if the conditions of the guarantee are met. In accordance with the normal rule on alternative obligations in III.–2:105 (Alternative obligations or methods of performance) the choice between repair or replacement is initially the guarantor's. If the item under guarantee can be easily and cheaply repaired it would clearly be unreasonable to give the consumer the choice of a replacement item.

Cost of invoking and performing the consumer goods guarantee. All the costs connected with invoking and performing the consumer goods guarantee are to be borne by the guarantor. The guarantor may deviate from this rule by indicating in the guarantee document that some costs are to be borne by the guarantee holder. However, such costs may not be disproportionately high. This particular provision aims to ensure that the consumer will not be surprised by an undisclosed liability for costs.

Illustration 2

The guarantee document provides that if the guarantee holder moves, he or she has to bear the increased costs if the remedies performed by the seller become more onerous. This could be, for instance, the increased costs of transportation connected with repair or replacement of the goods.

Illustration 3

The guarantee document may, for example, indicate that the guarantee holder has to bear the costs of a yearly inspection of the goods amounting to €10. Such an inspection is to assure proper and undisturbed functioning of the goods, as was guaranteed.

It should be noted that this provision only applies to the costs of invoking the guarantee. However, this rule is consistent with the fact that guarantees against payment fall under the scope of this Chapter (cf. IV.A.–6:101 (Definition of a consumer goods guarantee) Comment G).

IV.A.–6:105: Guarantee limited to specific parts

A consumer goods guarantee relating only to a specific part or specific parts of the goods must clearly indicate this limitation in the guarantee document; otherwise the limitation is not binding on the consumer.

COMMENTS

A. General

This Article concerns the situation when, viewed from the consumer's point of view, the coverage of the consumer goods guarantee is not as broad as may be expected. A

guarantee for a specific part or parts of the goods is usually given with respect to goods that contain various parts that differ with respect to their complexity, or parts that, due to their nature, are guaranteed in a specific way. Different parts of the goods may, for example, have a different durability or may require different maintenance of a specific nature. It also occurs quite often that some parts of the goods are not included in the guarantee at all.

Illustration 1

It is common that parts like bulbs, batteries, etc. are excluded from the scope of the guarantee.

Illustration 2

A guarantee document may specify that the basic guarantee for the entire goods is for 2 years. However, the plastic elements are guaranteed only for 1 year, whereas the metal elements are guaranteed for a period of 10 years.

B. Effectiveness of the limitation

In order to prevent confusion as to the factual coverage of the guarantee, all variations or exclusions of the guarantee coverage must be indicated clearly in the guarantee document. If there is no clear indication of the limitation, it is ineffective.

Illustration 3

B, a consumer, buys a computer to which a 3-year guarantee is attached. Two years after purchase, it is no longer possible to recharge the rechargeable battery. The consumer requests a new battery, invoking the guarantee. The seller contests this request and pleads that the battery is a “consumable” and therefore does not fall under the guarantee.

Since it is not self-evident that a battery of this type is to be regarded as a consumable item and the seller has not indicated any limitation as to the scope of application of the guarantee, the seller is obliged to replace the battery.

IV.A.–6:106: Exclusion or limitation of the guarantor’s liability

The guarantee may exclude or limit the guarantor’s liability under the guarantee for any failure of or damage to the goods caused by failure to maintain the goods in accordance with instructions, provided that the exclusion or limitation is clearly set out in the guarantee document.

COMMENTS

A. General

If special maintenance is required for the proper functioning of the goods, the instructions concerning maintenance should be provided to the buyer regardless of whether or not there is a guarantee attached to the goods (cf. IV.A.–2:302 (Fitness for purpose, qualities, packaging) sub-paragraph (e)). The guarantor may, however, offer the consumer goods guarantee subject to the condition that the guarantee holder will take special care of the goods, or will use or treat the goods in a specific way.

Illustration 1

The consumer goods guarantee may, for example, require the guarantee holder to undertake a periodical motor vehicle service at authorised garages, to have the goods repaired only at authorised repair points, or to use materials of a specific quality in order to maintain the goods.

B. Maintenance instructions

Presentation of the instructions. If the guarantor offers a consumer goods guarantee subject to the condition that the guarantee holder will use, treat or maintain the goods in a specific way, the relevant instructions must reach the consumer. There are many ways in which the guarantor may present the maintenance instructions to the guarantee holder. The instructions may be attached to the goods, for example printed on the box in which the goods are sold, or come in the form of an instruction guide (provided that the guarantee document refers to these instructions). It is also possible that the maintenance instructions may simply be included in the guarantee document itself.

The instructions have to be adequately explained to the consumer, i.e. in a way that leaves no doubt as to their meaning (cf. also IV.A.–6:103 (Guarantee document) paragraph (1)(d)).

Limiting liability via instructions. If the non-observance of the maintenance requirements is to result in a limitation or exclusion of the guarantor's liability under the guarantee, this has to be clearly indicated in the guarantee document. Merely attaching instructions to the goods or including them in the guarantee document does not have the effect of limiting the guarantor's liability in the case of non-observance by the guarantee holder.

Scope of the instructions. The maintenance instructions may exceed the normal scope of the maintenance instructions for consumer goods. As stated above, they may require the guarantee holder to take special care of the goods. The conditions have to be reasonable and introduced for a justified reason. This requirement must be specially underlined if the guarantor suggests using a specific brand of products for the maintenance of the goods in

question. Besides, the instructions cannot limit the scope of the normal use of the goods or impose excessive costs on the guarantee holder. In any case, all the additional maintenance costs, like the costs of yearly check-ups must be indicated in the guarantee document in accordance with IV.A.–6:104 (Coverage of the guarantee) sub-paragraph (d)).

The liability of the guarantor is not excluded or limited in the case of non-observance of the maintenance instructions if the same defect would have appeared even if the guarantee holder had observed the instructions. If it is not clear from the circumstances, it should be up to the guarantor to prove that the observance of the instruction would have made a difference.

Illustration 2

B, a consumer, buys a second-hand car with a guarantee attached from A, a car dealer. After one year the car breaks down. When B attempts to invoke the guarantee, A refuses the claim under the guarantee since B has not had the car serviced at an authorised garage as required by the guarantee conditions. Since in this case it is clear that for the defect in question it is irrelevant if the prescribed service had taken place at an authorised garage or at another garage, it is unreasonable to apply this condition.

IV.A.–6:107: Burden of proof

(1) Where the guarantee holder invokes a consumer goods guarantee within the period covered by the guarantee the burden of proof is on the guarantor that:

(a) the goods met the specifications set out in the guarantee document or in associated advertisements; and

(b) any failure of or damage to the goods is due to misuse, mistreatment, accident, failure to maintain, or other cause for which the guarantor is not responsible.

(2) The parties may not, to the detriment of the consumer, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General

One of the major advantages of a consumer goods guarantee is the presumption that any defect becoming apparent within the duration of the guarantee is automatically covered by that guarantee. Due to the importance of this presumption, this Article is mandatory and may not be deviated from to the detriment of the consumer. This solution differs from the general regulation on non-conformity in IV.A.–2:308 (Relevant time for establishing conformity) paragraph (2) where only a lack of conformity becoming apparent within six months from the time when the risk passes to the buyer is presumed to have existed at that time, unless this presumption is incompatible with the nature of the goods or the nature of the lack of conformity.

B. Burden of proof

The guarantor can escape liability under the consumer goods guarantee only by showing that the goods do in fact meet the specifications set out in the guarantee document or in the associated advertising. Alternatively, the guarantor may show that any failure of or damage to the goods is due to misuse, mistreatment, an accident, failure to maintain, or any other cause for which the guarantor is not responsible. In other words, the guarantor has to prove that either the defect at hand was not covered by the guarantee, or that it occurred after the guarantee had expired, or that other circumstances have occurred which exclude the liability (mainly damage caused by the consumer or by a fortuitous event).

Illustration 1

B, a consumer, buys a cellular phone from A with a one-year guarantee attached. According to the guarantee conditions the guarantee is not valid if the deterioration is due to external damage. Within the guarantee period the phone ceases to work and B therefore demands a repair free of charge. A refuses to repair the phone, claiming that it has been dropped, referring to scratches on the cover. B's explanation is that the scratches originate from a change of aerial. In this case, the evidence adduced by the seller is not sufficient to rebut the explanation provided by the buyer. B may therefore invoke the guarantee. If A had given better evidence of the probability of external damage as well as its influence on the functions of the goods in question the outcome may have been different.

However, it should be kept in mind that the guarantor does not begin to bear the burden imposed by this Article until the buyer has at least shown that the goods are not working, or something similar.

IV.A.–6:108: Prolongation of the guarantee period

(1) If any defect or failure in the goods is remedied under the guarantee then the guarantee is prolonged for a period equal to the period during which the guarantee holder could not use the goods due to the defect or failure.

(2) The parties may not, to the detriment of the consumer, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General

This Article addresses the situation when the consumer is deprived of the possession of the goods as a result of their defectiveness or failure. If, during the period covered by the guarantee, the goods fail and it is necessary to remedy them (primarily through repair), there are two consequences for the consumer. First, the guarantee holder will, in most cases, be deprived of the possession of the goods and, as a result, cannot use or benefit

from them. Secondly, the duration of the consumer goods guarantee keeps on running, despite the fact that the goods have failed to function as guaranteed and the guarantee holder cannot use them. This solution will also promote speedy action from the guarantor, since the guarantee will otherwise be prolonged. Especially for defects appearing at the end of the guarantee period, this regulation will provide the consumer with additional security. Due to the high risk of guarantors excluding the application of this principle, this Article is mandatory and may not be deviated from to the detriment of the consumer.

B. Prolongation of the guarantee period

According to the solution presented by this Article, the duration of the consumer goods guarantee is prolonged by the time during which the goods could not be used due to their failure. The period during which the consumer could not use the goods covers the period from the moment of the discovery of the failure of the goods until the moment of receiving back the remedied goods. In essence, the guarantee period is therefore merely interrupted rather than starting afresh. The guarantee period can be prolonged several times, if the goods have to be remedied (repaired or replaced) on more than one occasion.

Illustration 1

B buys a TV with an attached two-year guarantee. On June 15 the TV stops working. B notifies the seller and the TV is sent in for repair. B receives the TV back on July 15. The duration of the guarantee will be prolonged by one month.

PART B. LEASE OF GOODS

CHAPTER 1: SCOPE OF APPLICATION AND GENERAL PROVISIONS

IV.B.–1:101: Lease of goods

- (1) This Part of Book IV applies to contracts for the lease of goods.*
- (2) A contract for the lease of goods is a contract under which one party, the lessor, undertakes to provide the other party, the lessee, with a temporary right of use of goods in exchange for rent. The rent may be in the form of money or other value.*
- (3) This Part of Book IV does not apply to contracts where the parties have agreed that ownership will be transferred after a period with right of use even if the parties have described the contract as a lease.*
- (4) The application of this Part of Book IV is not excluded by the fact that the contract has a financing purpose, the lessor has the role as a financing party, or the lessee has an option to become owner of the goods.*
- (5) This Part of Book IV regulates only the contractual relationship arising from a contract for lease.*

COMMENTS

A. General

Scope of application. This Part of Book IV deals with contracts for the lease of goods and the rights and obligations arising from them. The contract is not itself the lease. It is a juridical act which gives rise to the lease (cf II.–1:101 (Definitions)). The lease is the legal relationship between the lessor and the lessee, involving obligations and corresponding rights on both sides, which is created and regulated by the contract. This Part of Book IV applies to what can be regarded as the “core” field of contracts for the lease of assets other than immovables, namely contracts granting a temporary right of use of goods against remuneration. Goods are defined (in Annex 1) as corporeal movables, including ships, vessels, hovercraft or aircraft, space objects, animals, liquids and gases. No doubt other types of contract may be found with some but not all of these elements or similar elements or functions to those referred to in the present Article, but it is not recommended that this Part of Book IV be given the widest possible scope of application. A menu of specific contracts can never be exhaustive or cover every possible contract. Neither is it possible to draw sharp lines between different specific contracts. There will be contracts with elements of two or more types. A negative definition of a contract for lease, excluding the application of other principles is hardly possible or desirable. One exception has been made: this Part of Book IV does not apply to contracts where the parties have agreed that ownership is transferred after a period with right of use, (paragraph (3)).

B. Contractual relationship only

Contractual relationship not proprietary rights. This Part of Book IV deals only with the contractual relationship arising from a contract for the lease of goods. It is not concerned exclusively with the relationship between the original lessor and lessee: Chapter 7 deals with new parties and subleases. However, it is concerned only with contractual rights and obligations. It does not deal with proprietary questions. In national law, protection and priority in relation to third parties may be decisive for distinguishing leases from other legal relationships which involve the use of goods, for example the right of usufruct that is employed in several jurisdictions. In most cases these rights will be more comprehensive than the right based on a contract for lease and for that reason fall outside the scope of application of this Part of Book IV. In other cases national law must determine to what extent this Part is applicable to such rights.

C. Right of use

Benefits and physical control. The essential meaning of “use” of goods is so evident in everyday language that it is difficult to give a definition that is not circular. A right of use implies that the lessee may enjoy the benefits that normally flow from having physical control of the goods: driving a car, sailing a boat, digging with an excavator, wearing a suit, watching programmes on a TV, etc. The lessee can do more than a pledgee or a person looking after the goods, but less than the owner, who may destroy the goods or make changes to them or establish rights related to the goods (the lessee’s rights concerning changes to, or the sublease of the goods will be dealt with later). The more exact limits within which the lessee may utilise the goods must be determined by the individual agreement, the purpose of the lease and the default rules in this Part (Chapter 5).

Fruits. This Part of Book IV makes no distinction between the right to use the goods and the right to “fruits”. For goods, as opposed to immovable property, this distinction is normally of little relevance. Whether or not the lessee may keep natural fruits like the foal of a leased horse or the tomatoes from a leased tomato plant must be determined from the purpose of the lease and other circumstances. It has not been deemed useful to formulate a default rule. Fruits understood as income from a new lease are possible if the lessee may sublease the goods, an issue that will be dealt with in Chapter 7.

Consumable goods, fungible goods, aggregates. The right to consume goods belonging to another person or to return objects other than those originally made available is usually seen as something different from “use”, in everyday language as well as in legal language. This Part does not apply to contracts concerning such rights. On the other hand, there seems to be no reason to exclude leases of aggregates of goods, for example a set of tools for computer repairs. To what extent the lessee may replace parts of the aggregate will depend on the individual agreement and the circumstances.

Intellectual property rights. The purpose of leasing a book or a DVD (etc.) is normally to get access to the contents – reading the verses, listening to the music, watching the film etc. This Part deals with the individual copy of the work, not with questions regarding

intellectual property rights. If, however, the law on intellectual property should require an illegal copy to be returned immediately or to be destroyed or at least not used by the lessee, this has consequences also for the lease agreement, as the item cannot be used for the purpose for which it was intended.

D. Temporary right

The right of use is not permanent. The lessee's right under a contract for lease is not permanent. A contract permanently dividing the interests in the goods in a way that gives one party a right of use while the other party is left with a right of payment should not be regarded as a contract for lease. However, this Part contains no maximum lease period and the difference between a right of use under a contract for a very long period on the one hand and a permanent right of use on the other may be rather formal (cf. Chapter 2). For leases of goods this will probably not be a problem of practical significance in any case.

E. Goods

Meaning of "goods". The meaning of the word "goods" is determined by a series of definitions (see Annex 1): "Goods means corporeal movables. It includes ships, vessels, hovercraft or aircraft, space objects, animals, liquids and gases." "Movables means corporeal and incorporeal property other than immovable property." "Immovable property' means land and anything so attached to land as not to be subject to change of place by usual human action." "Corporeal, in relation to property, means having a physical existence in solid, liquid or gaseous form."

Movables. This Part applies to movables and not to immovable property. Objects that form part of immovable property, as well as fixtures and accessories to immovable property, should be regarded as immovable property in this respect, unless such property is leased with a view to separating it from the immovable property. Hence a contract concerning the right to utilise a pipeline or a cable fixed to an immovable does not fall within the scope of this Part.

Corporeal movables. This Part applies to leases of corporeal movables only, i.e. movables with a physical existence. In practice, it will be movables in solid form, but it has not been found necessary to make exceptions for liquids or gases. Electricity, information and data are not covered by the definition of goods, neither are financial instruments, even in the form of negotiable documents.

Ships, aircraft etc. The word "goods" includes "ships, vessels, hovercraft or aircraft" (see Annex 1) and this Part applies to leases of such objects. In most, if not all, jurisdictions, there are registers for several of these objects, registers that also allow for the registration of rights attaching to such objects. Rights relating to ships, aircraft etc. are to a certain extent governed by rules similar to rules on immovable property, which is also registered. It has not been found necessary to exclude ships, aircraft etc. from the scope of application of this Part, nor to include special rules on leases of such objects. For leases of ships and aircraft of some size, there are standardised contract terms, and in any

case the parties to the contract will make individual agreements covering all important aspects of the contractual relationship. This Part of Book IV is non-mandatory where the lessee is not a consumer. However, there are lease contracts, typically concerning smaller boats for leisure purposes, where standardised terms are not relevant and individual agreements often less elaborated. For such leases there is no reason to have special rules.

F. In exchange for money or other value

Gratuitous contracts excepted. This Part applies only where the right of use is provided in exchange for money or other value. Contracts concerning gratuitous use of goods have traditionally been regarded as a contract type different from the contract for lease and the typical interests involved in such a relationship are not the same as for leases. These contracts are dealt with in Book IV.I (Gratuitous Contracts). However, where remuneration is owed and it is not purely symbolic, this Part of Book IV applies. Contracts with a low rent are not excepted from the scope of application of this Part, but the fact that the rent is low may in some circumstances be relevant (for example in deciding the standard of quality of the goods that may reasonably be expected by the lessee).

Money or other value. In most cases the lessee is obliged to pay money, but this Part applies also where the right of use is provided in exchange for other value, such as work, services, ownership or use of property etc. The rules in Chapter 5 concerning payment apply with appropriate adaptations in such cases. Leases with remuneration in value other than money are so rare that it has not been found advisable to burden the text with special rules. Sometimes the right of use must be seen as an element of another contract, e.g. an employment contract, and in such cases this Part does not apply.

G. Contracts for lease and contracts for sale

Sales rules have priority. This Part does not apply to contracts where the parties have agreed that ownership is to be transferred after a period with right of use, cf. the third paragraph of the present Article. If the parties have already agreed on the transfer of ownership, and this transfer is not just an option for one or other of the parties, the contract falls under the definition of a contract for sale in IV.A-1:202 (Contract for sale). The agreed transfer of ownership may take place at once or after a certain period, normally on the condition of full payment of the price. The most important example is a sale with reservation of title. It sometimes happens that lease terminology is used in agreements of this kind; the lessee becomes owner when the agreed rent is paid in full. The contract is still covered by the definition of a contract for sale. The language of such contracts (hire-purchase, conditional sale, sale with retention of title) may differ without corresponding real differences in the obligations undertaken by the parties, and it would be arbitrary to apply lease rules for the period up to transfer of ownership just for some of the contracts. In general, it is not always clear to what extent the applicability of rules concerning one type of contract excludes the applicability of rules concerning other types of contracts. Sometimes the rules may be applied in combination, each to different elements of the same contract; in other cases, obligations characteristic of one specific contract are just accessory elements in a contract that is governed by the rules of another type of contract. This may depend on the circumstances of the case, see also II.-1:108

(Mixed contracts). However, for lease contracts a clarification should be made in relation to the sale contracts mentioned here. The question remains whether the use of lease terminology should mean that lease rules apply *by agreement*. This is a question of interpretation of the individual agreement, but in most of these cases the use of lease terminology can simply be seen as a matter of form.

Lessee's option to buy. A mere option for the lessee to buy the goods, either at the end of the lease period or at any other point in time, does not make the contract a contract for sale under the definition in IV.A.–1:202 (Contract for sale), and neither does it exclude the contract from the lease definition. This is the case even if it can be proved that the lessee has an intention to use the option, as long as this is not a contract term. The same holds true where the price is so low that it would be obviously irrational *not* to use the option; this Part of Book IV still applies.

Sale and lease back. Sometimes one person (A) sells goods to another person (B) with the purpose of leasing the goods from that person. Depending on the circumstances, B's right may be regarded as a security right and A's right as ownership, cf. Book IX (Proprietary Security Rights in Movable Assets). Also as between A and B, the contracts for sale and for lease may be seen as simulations, again depending on the circumstances, and if so, this Part of Book IV will not apply. In other cases, this Part of Book IV should apply for the part of the contract concerning the lease.

H. Contracts where goods are supplied for the particular lease (“financial leasing” etc.)

The contracts. It is quite common that the lessor has a role more of credit provider than ordinary lessor: the prospective lessee finds a supplier who can provide goods conforming to the lessee's specification; the goods are then bought by another party, typically a financial institution, who leases the goods to the lessee; a rent and a minimum lease period are fixed such that the cost of the goods, plus interest, may be recovered by the lessor at the end of the lease period. The lessee may have a right to buy the goods at expiry of the lease period at a nominal price or a right to continue the lease at a substantially lower rent. Such contracts are often referred to as “financial leasing contracts” (cf. the following paragraph). Similar transactions may be defined in national legislation under various names. One should be aware that the English term “leasing”, as well as more or less analogous terms in other languages, is frequently used for transactions that have only some of the characteristics here mentioned or important additional traits.

The Unidroit Convention. The Unidroit Convention on International Financial Leasing was adopted in Ottawa 28 May 1988 and entered into force on 1 May 1995, following three ratifications. To date (2007), the Convention has been ratified by nine states (Belarus, France, Hungary, Italy, Latvia, Nigeria, Panama, Russia and Uzbekistan). According to article 1 the Convention applies to international lease contracts (contracts “granting to the lessee the right to use the equipment in return for the payment of rentals”) where (a) the lessee controls acquisition of the goods (the lessor buys the goods

on specifications by the lessee and on terms approved by the lessee, from a supplier selected by the lessee; and the lessee specifies the goods and selects the supplier “without relying primarily on the skill and judgement of the lessor”); (b) the goods are acquired by the lessor in connection with the lease agreement and this is known to the supplier; (c) the rent is “calculated so as to take into account in particular the amortisation of the whole or a substantial part of the cost”.

Essential rules of the Unidroit Convention. The essence of the regulation of the Convention is the following.

- (a) The lessor’s rights against creditors are protected (art. 7).
- (b) The lessor, in the capacity of lessor, is protected against claims from third parties resulting from “death personal injury or property damage” (art. 8(1)(b)).
- (c) The supplier’s duties under the supply agreement are also “owed to the lessee as if it were a party to that agreement” (art. 10).
- (d) The lessor “warrants” against third party rights in the goods (art. 8(2)).
- (e) All maintenance and repairs lie on the lessee and the goods must be returned in the original condition, normal wear and tear excepted (art. 9).
- (f) In the case of non-conformity or delay, the lessor must accept termination (or rejection of delivery) and, prior to acceptance of the goods, withholding of rent, but is not required to pay damages, except for loss resulting from the lessee’s reliance on the lessor’s skill and judgement or the lessor’s intervention in the choice of supplier or in specifications (art. 12 and art. 8(1)).
- (g) There are provisions on damages etc. relating to termination as a result of the lessee’s non-performance (art. 13).
- (h) There is regulation of the right to transfer ownership of the goods or the right of use (art. 14).

The Unidroit Convention and this Part of Book IV. The contracts described in the Unidroit Convention form one group of lease contracts containing elements of credit and security. The lease form is chosen by the parties. Little seems to be won by defining these contracts as contracts of their own kind, different from lease contracts and thus falling outside the scope of application of this Part. Defining the contracts as sale contracts would certainly be contrary to the wishes and intentions of the parties, and there is not sufficient reason to go against such intentions. This Part of Book IV should apply in general. Nevertheless, some special rules must be included as it would be unsatisfactory to have all of the lease rules apply as default rules to a – more or less – distinct and important group of contracts where some of the general rules do not fit. Such special rules are included in IV.B.–2:103 (Tacit prolongation), IV.B.–3:101 (Availability of the goods), IV.B.–3:104 (Conformity of the goods during the lease period), IV.B.–4:107 (Remedies channelled towards supplier of the goods) and IV.B.–5:104 (Handling the goods in accordance with the contract) and reference is made to Comments to these Articles.

I. Lease contracts and service contracts

Right of use combined with services. The right of use of goods may be combined with services from the party providing the right of use. There is a wide spectrum of possible combinations. At one end of the spectrum, work to be done by the lessor in the form of maintenance and repairs is an integral part of a great many lease contracts and such work is normally not considered a “service” at all. This Part of Book IV will apply. At the other end of the spectrum, there are contracts where the “use” of goods has no independent character and is merely accessory, such as the passenger’s “use” of a car or a boat under a transportation contract. The categorisation is more doubtful where for example a party has the right of use of advanced industrial equipment and the owner provides a mechanic to take care of the equipment throughout the period of use.

Applicability of this Part of Book IV. A general rule on mixed contracts is found in II.-1:108 (Mixed contracts). Rules applicable to each relevant category may apply to the same contract, unless (among other things) one part of the mixed contract “is in fact so predominant that it would be unreasonable not to regard the contract as falling primarily within one category”. Both sets of rules may apply where the services to be performed and the right of use are only loosely connected and there is no practical risk of incompatible regulation, for example where surfing lessons are included in the lease of a surfboard. In other cases, different sets of rules cannot easily be combined as they may regulate more or less the same elements of the contract, and rules may be conflicting. In such cases, one part of the contract may often be regarded as predominant. Where the owner or the owner’s representative has control of the use of the goods, the service element will normally be dominant. A contract concerning a bus with driver will for example normally imply that the driver decides *how* to drive, while the client decides *where* to drive and *when*. This should not be regarded as a lease. A parallel distinction between “nautical” control and “commercial” control is well known from charter parties. Where the control aspect does not give sufficient indication, the extent and intensity of the service element and the qualifications required to provide such a service should be weighed in the balance. Furthermore, the value of the different elements of the contract may be relevant.

J. The parties

Lessor need not be the owner. In most cases the lessor is the owner of the goods. There may be situations, however, where the lessor may rightfully enter into a contract for lease without being the owner. Such may be the case for the holder of a usufruct right, a right acknowledged in several jurisdictions. Further, where the lessee can sublease the goods, the lessee in the role of sub-lessor is not the owner of the goods.

Lease-and-lease-back etc. In principle, one person (A) may lease the goods to another person (B) and then lease the goods back from B. Such transactions are now and then seen for immovable property, but are probably of small practical interest as far as goods are concerned.

IV.B.-1:102: Consumer contract for the lease of goods

For the purpose of this Part of Book IV, a consumer contract for the lease of goods is a contract for the lease of goods in which the lessor is a business and the lessee is a consumer .

COMMENTS

A. Consumer rules and structure of the draft

Consumers and contracts for the lease of goods. Contracts for lease to which consumers are parties require special attention. Consumers typically have less bargaining power and less information concerning the leased goods, the law and the circumstances of the contract than businesses. Rules protecting consumers' interests as contracting parties are common both in national law and Community legislation. Consumers may be parties to lease contracts as lessors, as lessees or both. Constellations in which the consumer is lessor and the business is the lessee ("consumer-to-business") are probably not very frequent as far as goods are concerned and it has been deemed unnecessary to include particular rules for these situations. Lease contracts where both parties are consumers ("consumer-to-consumer") are more common, but consumer protection rules are not needed here either, as the typical element of inequality of the parties is not present. It should, however, be considered whether certain rules may create problems where both parties are non-professionals. Consumer protection rules should apply to contracts where the lessor is a business and the lessee is a consumer. This is comparable to consumer protection rules already in existence in national law, Community legislation and other parts of these model rules.

General principles and consumer contracts. Several consumer protection rules are found in general parts of these model rules that apply to several or even all contracts between businesses and consumers. Examples are rules on non-discrimination and information duties at the pre-contractual stage, the right to withdraw from certain contracts, and rules on unfair terms. Some of these rules apply to contracts between businesses as well. It is not necessary to repeat general protection rules in this Part of Book IV.

Consumer protection in this Part of Book IV. The consumer rules of this Part of Book IV are found in the relevant chapters according to their content. Two alternative structures were considered but rejected. One was to gather all special rules concerning consumers in one chapter. This would have had the advantage of making it easier to get an overview of consumer protection. However, it would also have had negative effects, in so far as obliging the reader to consult both the relevant substantive chapter and the consumer chapter in order to get the full picture. A second alternative was to have a separate set of principles for consumer contracts for lease, setting out all the applicable rules, whether deviating from or identical to the rules concerning business-to-business leases (and consumer-to-consumer leases). This would have allowed the consumer to consult just one set of principles. Rules dealing with consumer contracts for lease in

particular are, however, rather few, and a separate set of principles would have implied extensive repetition of general provisions. It must also be borne in mind that it would have been necessary for the consumer to consult general parts of the model rules in any case, it not being feasible to gather under one heading absolutely all rules that might affect a consumer contract for lease.

Mandatory rules. Consumer protection rules may not normally be derogated from by the parties to the detriment of the consumer. Where, however, the consumer has notified the other party of a non-performance, the parties are free to make a settlement concerning the effects of the non-performance within the ordinary frame of freedom of contract applicable also to consumer contracts. In other words, the consumer may not as a rule waive rights *beforehand* (see II.–1:102 (Party autonomy)). Further, the parties are in most cases free to decide whether or not to enter into a contract and to agree on what is to be leased, when, for how long and at what price. Some restrictions, though, follow from rules on information duties, unfair terms etc. The mandatory rules found in this Part of Book IV mainly concern the effects of non-performance. This holds true also for IV.B.–3:106 (Limits on derogation from conformity rights in a consumer contract for lease), a provision limiting the possibility to include terms which waive or restrict the rights resulting from the lessor’s obligation to ensure that the goods conform to the contract.

B. Definition of consumer contract for lease

Consumer contract definition for the purpose of this Part of Book IV. Under Annex 1, both “consumer” and “business” are defined. These definitions apply for the purposes of the present definition of a consumer contract for lease. The definition covers only business-to-consumer contracts, not consumer-to-business or consumer-to-consumer contracts; cf. Comment A. The provision in IV.A–1:204 (Consumer contract for sale) has a corresponding definition for that situation.

Consumer. Under the definition in Annex 1 a consumer is a “natural person”, i.e. legal persons (associations, companies, public law entities etc.) are not consumers. Further, the person must act “primarily for purposes which are not related to that person’s trade, business or profession”. The lessee’s intended use of the goods is irrelevant as long as the lease is not for trade, business or professional purposes. If, for example, the lessee intends to sublease the goods, the lease remains a consumer contract for lease as long as the sublease is not primarily related to the lessee’s trade, business or profession.

The lessor. The lessor may be a natural or a legal person. The lessor does not have to be a full-time professional, but the activities must be of a kind that would normally be qualified as a “business”.

CHAPTER 2: LEASE PERIOD

IV.B.–2:101: Start of lease period

(1) *The lease period starts:*

- (a) *at the time determinable from the terms agreed by the parties;*
- (b) *if a time frame within which the lease period is to start can be determined, at any time chosen by the lessor within that time frame unless the circumstances of the case indicate that the lessee is to choose the time;*
- (c) *in any other case, a reasonable time after the conclusion of the contract, at the request of either party.*

(2) *The lease period starts at the time when the lessee takes control of the goods if this is earlier than the starting time under paragraph (1).*

COMMENTS

A. Lease period and contract

Performance during a period of time. It is a characteristic trait of the contract for lease that the obligations under it are performed over a period of time. During this *lease period* the lessor has an obligation to make the goods available for the lessee's use and the lessee has corresponding obligations to pay the rent and take care of the goods. The lease period does not necessarily start immediately on the conclusion of the *contract*, and the contractual relationship may also continue after the lease period has ended. The contract for lease is different from contracts where the obligations are performed "momentarily", like sales contracts, but it differs also from many contracts where the obligations are performed over time. The lessor's main performance consists in making the goods available for the lessee's use *for a period of time* and the remuneration is normally calculated for a certain period or per time unit. It is not a question of paying for work done or a quantity supplied, as in many service contracts.

Model of regulation. The present Chapter defines the lease period by fixing the start of the lease period in the present Article and the end of the lease period in the following Article. In addition, prolongation of the lease period based on continued use after expiry is dealt with in IV.B.–2:103 (Tacit prolongation). Defining the lease period means introducing a notion required for regulation; the obligations of the parties are thus decided only indirectly by the present Chapter. Rather, the lease period is an important element of rules found in other chapters: normally the lessor has an obligation to make the goods available for the lessee's use during the lease period, normally the rent must be paid for the lease period, normally the lessee must take care of the goods during the lease period, etc. An alternative model would be to regulate each issue separately, independently of the notion of a lease period, with provisions on the time at which performance can be claimed, provisions on the time when the duty of care starts, provisions on the time when the goods must be returned, etc. In national legislation the

notion of a lease period is common, in most cases the length or the end of the lease period being fixed. Provisions on the start of the lease period are more unusual.

B. Non-mandatory character

The rules are non-mandatory. In the main, the rules of the present Chapter are non-mandatory. However, it would be contrary to fundamental principles to bind the parties to a contract for an indefinite period without the possibility to terminate the relationship. This also applies to agreements concerning the lease period, but it has not been found necessary to spell it out in the present Chapter. Paragraph (4) of IV.B.–2:103 (Tacit prolongation), on rent for a period after tacit prolongation of certain contracts, cannot be derogated from to the detriment of a consumer in a consumer contract for lease. Consumer contracts for lease are further discussed under Comment G.

C. Start of lease period

Significance. The start of the lease period signifies the point in time from which the lessor is obliged to make the goods available for the lessee's use and from which the lessee is obliged to pay the rent. Depending on the agreement and the circumstances, it may be that the lease period starts although the lessee has not accepted the goods and even if the goods are not made available as a result of the lessor's non-performance.

D. Time determinable from the contract

Time determinable from terms agreed by the parties. In many cases the start of the lease period is agreed upon explicitly by the parties – in a written document or in some other form, cf. II.–1:107 (Form). It may be a precise date or hour, but the time can also be fixed in other terms, e.g. linked to a future event. In other cases, the beginning of the period can be determined from the circumstances, e.g. where it is obvious that the lessee will receive the goods immediately.

Start within a time frame. There may be situations in which no fixed start time for the lease period can be determined, even if it is agreed that the lease period is to begin within a specified time frame or by a certain time. The rule in III.–2:102 (Time of performance) paragraph (2) is that performance may be effected by the debtor “at any time within that period” unless the circumstances show that the other party is to choose the time. In other words, the party owing performance has the choice if the circumstances do not show otherwise. In more specific provisions for a certain type of contract, such as lease contracts, it is better to clarify which party has the choice as a default rule. It is not possible to say that one of the parties *typically* needs the benefit of choice more than the other. In many cases the lessor must acquire the goods and make them ready for the lessee's use. On the other hand, the lessee will often have to make some preparations for receiving the goods. The default rule in paragraph (1)(b) of the present Article is that the lessor determines the start of the lease period within the agreed interval. It should be noted, however, that the lessee has no onerous burden of proof in showing that the choice lies on the other side. In many cases it is a matter of taste whether one considers the start of the lease period to be determinable from the contract or whether it is a question of choice by one of the parties within a specified time frame.

Illustration 1

A plans to go to Paris next week and leases a car for that purpose. The parties agree that A will pick the car up at the lessor's business place. The circumstances indicate that the lease period starts when A picks up the car some time during the following week.

E. Time not determinable from the contract

Start within a reasonable time. Where no time or time frame for the start of the lease period is determinable from the terms agreed by the parties, the lease period starts at the request of either party within a reasonable time after the conclusion of the contract. This corresponds to III.–2:102 (Time of performance) paragraph (1), with the difference that the start of the lease period must be *requested*. Without this prerequisite, there would be a risk of starting the lease period before both parties are aware of it, e.g. in a case where the goods have been made available for collection by the lessee. Even if the request is made a reasonable time after the conclusion of the contract, it may be that the other party still needs reasonable time after the request has been made in order to prepare to make the goods available or to take control of the goods. What is reasonable depends on the kind of goods leased, the intended length of the lease period, whether the goods are available at the conclusion of the contract etc., cf. also “reasonable” in Annex 1. Should the case be that no party requests the start of the lease period and no such start time is given by the terms of the contract, the outcome must depend on the circumstances. If the lessee takes control of the goods, this is decisive (second paragraph of the present Article). It may also be that the contract has fallen away – the lessee no longer needs the goods and the lessor does not insist on performance.

F. The lessee takes control of the goods

The lease period starts when the lessee takes control of the goods. The lease period starts when the lessee takes control of the goods, even if this happens earlier than the time specified as the start of the lease period, e.g. earlier than the time fixed by the agreed terms or, if no such time follows from the terms, the time that would be considered reasonable. In most cases such early acceptance is based on an explicit agreement to start the lease at this point in time. The second paragraph of the present Article states a default rule for situations where there is no such agreement. The rule is non-mandatory and the parties may agree – or it may follow from the circumstances – that the lease period is to start at a later point in time. It is not sufficient for an early start of the lease period that the lessor has done what is necessary to make the goods available (e.g. by making the goods available for the lessee to pick up), if the lessee does not take physical control of the goods. This may be the case even where the goods are brought to the lessee. The term “take control” in the present Article refers only to the passing of the goods from the lessor to the lessee and does not in itself imply any approval of the conformity of the goods. It should also be noted that the lessee has no duty to accept early performance (III.–2:103 (Early performance) paragraph (1)).

Illustration 2

The lessor brings the leased tractor to the lessee's farm and leaves it there one week earlier than the agreed start of the lease period. The lessee is not at the farm and finds the tractor on returning home a couple of days after the agreed start of the lease period. The lessee has not taken control of the goods and the lease period starts at the time previously agreed.

Lessee's obligations affected by early acceptance of the goods. The general principle in III.-2:103 (Early performance) paragraph (2) is that a party's acceptance of early performance by the other party does not affect the time fixed for the performance of the party's own obligation. Paragraph (2) of the present Article represents a deviation from this principle as acceptance of an earlier start of the lease period has consequences for the lessee's obligations as well. The lessee's obligation of care is performed continuously and performance should start from the moment control of the goods is taken. The rent should also accrue from acceptance of the goods. Whether or not the *time of payment* is affected depends on the agreement. If rent is payable for example every seven days, early acceptance will have an effect on the time of payment. The situation may be different if rent is to be paid on certain dates, for example at the end of each calendar month.

Effects on length of lease period. Early acceptance of the goods will have no direct consequences on the length of an indefinite lease period. In other cases the effects of early acceptance will depend on the circumstances. If it is agreed that the lease period will end at a certain hour or date, early acceptance of the goods will normally not imply any change to this and the lease period will then be longer than originally agreed. If, on the other hand, the lease period is agreed to be so many days (hours, years), early acceptance will normally mean that the lease period *ends* earlier as well, and that the length of the period is not affected.

G. Consumer contracts for lease

No need for consumer rules. The rules of the present Article are of a general kind and should not give rise to any need for special regulation of consumer leases. This is true also for sub-paragraph (b) of the first paragraph, which leaves it to the lessor to determine the exact start of the lease period within an agreed time frame unless the circumstances indicate otherwise. There is no reason to believe that this rule will lead to abuses. Cases where the lessor has this option for an unreasonably long period must be dealt with under general rules on unfair terms.

IV.B.-2:102: End of lease period

(1) A definite lease period ends at the time determinable from the terms agreed by the parties. A definite lease period cannot be terminated unilaterally beforehand by giving notice.

(2) An indefinite lease period ends at the time specified in a notice of termination given by either party.

(3) A notice under paragraph (2) is effective only if the time specified in the notice of termination is in compliance with the terms agreed by the parties or, if no period of notice can be determined from such terms, a reasonable time after the notice has reached the other party.

COMMENTS

A. Definite or indefinite lease period

Two main types. Generally speaking, there are two main types of agreements concerning the lease period: leases for a *definite period* of time and leases for an *indefinite period*. A lease for an indefinite period can be terminated by giving *notice of termination*. Normally, a lease for a definite period cannot be terminated unilaterally beforehand by either one of the parties giving notice.

Combinations. Combinations of definite and indefinite lease periods are common. The parties may agree, for instance, that the lease period will end in any case at a fixed point in time, but that one or other of the parties may terminate the lease prior to this date by giving notice. One also finds agreements such that the lease period may end for example at the expiry of each year (every second year, third year etc.), but only if notice of termination has been given by one or other of the parties by a certain date. This may be regarded as a lease for an indefinite period under which notice of termination may be given only at certain intervals.

B. Non-exhaustive regulation

Rules on ordinary termination. The expiry of a definite lease period and termination by giving notice according to the rules of the present Chapter amount to ordinary termination of the lease period. A party does not need to have a special reason to give notice and has no duty to explain to the other party why notice is given. Termination of the contract, and thus also the lease period, may in other cases be the result of *non-performance*. This is dealt with in other chapters. Termination can result from other general rules as well, e.g. rules on changed circumstances. Some national systems have general rules allowing each party to terminate long-term contracts “for an important reason”. There is no general provision on such extraordinary termination under this Part of Book IV. Neither has it been found necessary to include rules on extraordinary termination in the case of the lessee’s death. Such rules are found in some jurisdictions, but under this Part general rules on termination by notice and on specific performance will apply.

No protection against ordinary termination. This Chapter contains no provision allowing the courts to avoid or set aside a notice of termination on the grounds that it is unreasonable. In national legislation it is quite usual to have rules concerning leases of dwellings and even business premises protecting the lessee against termination of the contract by the lessor. This is, however, not the case when it comes to the lease of goods.

Non-mandatory character. The parties may derogate from the rules of this Article, They may, for example, give one party a right to terminate a definite lease period by giving a specified period of notice.

C. Definite lease period

6. Time determined from the contract. A time for expiry of the lease period may be determinable from the contract. An agreement on a definite lease period may have various forms. The simplest form is to agree that the lease period ends on a future day or at a certain hour of day. It is also possible to agree upon the *duration* of the lease period, so many hours, days etc. counted from the start of the lease period. Expiry of the period may further be defined as a future *event* that will normally occur sooner or later. The event might for example be the fulfilment of the lessee's *purpose* of leasing the goods, e.g. where equipment is leased for a specific building project. A contract for a person's lifetime is a contract for a definite period. If the parties have agreed that the lease period will end upon the occurrence of an event that is *not* certain to happen, this agreement is effective, in the sense that the lease period expires on the occurrence of the event (resolutive condition). However, in relation to the second sentence of paragraph (1) of the present article, stating that a definite period cannot be terminated beforehand by giving notice, a period ending on the occurrence of an uncertain event cannot be considered an agreement to a definite lease period (see *below*).

Illustration 1

A and B agree that A has a right to use B's car until B is back from holiday. The lease period ends at a certain point in time, even though there always is a risk that B could have an accident and never return.

Illustration 2

C leases scaffolding for a construction project. The lease period ends when the project is completed or has reached a stage where the scaffolding is no longer needed.

A definite lease period ends without notice. If expiry of the lease period is fixed by or determinable from the contract, the period ends at this time without any prior notice. The lessee has no right to use the goods after the end of the lease period and continued use will normally amount to non-performance of an obligation on the part of the lessee. Continued use may, however, lead to prolongation of the lease period (IV.B.-2:103 (Tacit prolongation)).

Definite lease period cannot be terminated unilaterally beforehand. Where expiry of the lease period can be established from the contract, the parties have in most cases intended that there be no right to terminate the lease unilaterally before that time by giving notice. This is the default rule in the second sentence of the first paragraph of the present Article. The parties may, on the other hand, agree that the lease period is to end at a fixed time *or* by notice given by either party. Agreements to this effect may take

various forms, e.g. that notice may be given only for certain reasons or only by one of the parties.

Notice of termination if end of lease period is an uncertain event. The parties may have agreed that the lease period will end upon the occurrence of a future event that is not certain to occur (something that may or may not happen). If the agreed event occurs, the lease period will end (Comment C first paragraph). In these cases, however, both parties should have the right to terminate the lease period by giving notice of termination. If not, the lease period could in principle be permanent, which is not acceptable. This means that the lease period is not seen as definite in this respect.

Illustration 3

A, a building contractor, leases a machine to B. The parties agree that B will return the machine if A gets the town hall contract that has been tendered for. If A gets the contract, the lease will end without notice. Both parties have, however, a right to end the lease period unilaterally by giving notice as it is not certain whether A will obtain the contract or not.

No maximum period. There is no provision on the maximum length of the lease period. Such rules are found in some national systems. It is not always clear what the background to such rules on maximum lease periods is. They may be inspired by related restrictions concerning leases of immovables whose purpose is, for example, to secure certain ownership structures, preventing feudal ownership etc. The rules may also originate from a wish to clarify the systematic and practical line between leases and transfer of ownership. It might further be noted that a principle of disallowing permanent contractual relationships, without exit clauses, is of limited significance if very long lease periods are permitted. A lease of goods for 100 years or 1000 years is of course equal to a permanent contract. On the other hand, fixing a maximum length for lease periods would be somewhat arbitrary; it is not easy to find criteria based on legal, economic or practical arguments as to what the maximum length should be. If the length of the lease period makes the contract obviously unreasonable, recourse should be had to more general principles of immorality, hardship etc., cf. II.-7:301 (Contracts infringing fundamental principles). It must also be mentioned that IV.B.-6:103 (Right to enforce performance of monetary obligations), corresponding to III.-3:301 (Monetary obligations), limits the extent to which performance can be enforced. According to this principle, the performance of a more or less permanent contract may be transformed into a monetary settlement.

D. Indefinite lease period

Definition. A lease period that does not end at a time fixed by or determinable from the contract is an indefinite lease period. This definition in itself bears no significance except for the rule in paragraph (2) of the present Article that either party may terminate the lease period by giving notice. As stated in Comment C9, the lease period is seen as indefinite in this respect even if it is agreed that the lease period will cease on occurrence of an uncertain event.

Right to terminate the lease period by giving notice. Either party has the right to terminate an indefinite lease period unilaterally by giving notice, cf. paragraph (2) of the present Article. An agreement preventing one or other party from terminating an indefinite lease period would be contrary to general principles, see Comment C10. Should the parties agree that a notice of termination will only have effect after a significant lapse of time, the same questions arise as for agreements for very long definite lease periods.

Notice General rules on notice are found in II.–1:106 (Notice). There are no requirements of form for a notice of termination: it may be given in writing or otherwise. Form requirements may, however, follow from the contract. A notice becomes effective when it reaches the addressee. Normally, the lease period does not end immediately, but only after an agreed lapse of time or after a reasonable time. The calculation of this interval starts when the notice has reached the addressee, cf. paragraph (3) of the present Article. The notice may specify a lapse of time longer than that required by the contract.

Illustration 4

It follows from the contract that either party may terminate the lease period with one week's notice. Notice of termination is mailed on Friday and reaches the lessor on a Monday. The lease period ends the following Monday.

Illustration 5

It is agreed that either party may terminate the lease period at the end of the following calendar month by giving notice. A notice of termination is mailed on 31 January and reaches the addressee at 2 February. The lease period ends on 31 March.

Illustration 6

As illustration 5, but it is specified in the notice that it takes effect from 30 April. The lease period ends on 30 April.

Period of notice of agreed or reasonable length. The lapse of time between the giving of notice and the end of the lease period may be specified in the contract or otherwise determinable from the terms agreed by the parties. See illustrations 4, 5 and 6 above. If no such time can be determined from the terms, the period of notice must be reasonable. According to Annex 1, “what is ‘reasonable’ is to be objectively ascertained, having regard to the nature and purpose of what is being done, to the circumstances of the case and to any relevant usages and practices”. More specific factors are listed in IV.E–2:302 (Contract for indefinite period) concerning notice of termination in commercial agency, franchise and distribution contracts. The factors there listed are to some extent relevant for contracts for lease as well: the time the contractual relationship (here, the lease period) has lasted, reasonable investments made by either party, the time it will take to find alternatives, and usages. For lease contracts, in particular, regard should in addition be had to the period according to which the rent is calculated. The period for calculation

of rent often reflects the time horizon of the contract. A fishing boat at a hotel is leased by the hour, a car by the day, a truck by the week, etc. If rent is agreed for very long periods (several months, a year), it may be that other circumstances indicate that a shorter period of notice must be allowed. Likewise, it may be that the rent period is too short to indicate the period of notice, for example where day rates are agreed in a ship lease. Another factor relevant to contracts for lease is the character of the goods leased. A reasonable period of time for giving notice to terminate will typically not be the same in a contract for the lease of a bathing suit at a holiday resort as for, say, equipment for building construction. The examples also illustrate that the purpose of the lease must be taken into account.

E. Consumer contracts for lease

Unreasonably long lease period. A maximum length for the lease period is not specified by this Part of Book IV, cf. Comment C, last paragraph. Consumer contracts for lease will normally not be entered into for very long periods, but there may be exceptions, for example where a contract is functionally an alternative to sale and the lease period equals the expected useful lifetime of the goods. The problems with setting a maximum period are the same for consumer contracts for lease as for contracts for lease in general, cf. Comment C, last paragraph.

Extraordinary right to terminate lease period? It is explained in Comment C, last paragraph that IV.B.–6:103 (Right to enforce performance of monetary obligations), corresponding to III.–3:301 (Monetary obligations), limits the right to enforced performance: future rent cannot be claimed if the lessee wants to return the goods and it would be reasonable for the lessor under the circumstances to take the goods back. The lessor can still claim damages for the loss caused by the lessee's non-performance, but the lessor must take reasonable steps to reduce the loss, cf. III.–3:705 (Reduction of loss), including leasing or selling the goods to another customer. Thus, the lessee will still have to put the lessor "as nearly as possible into the position in which the creditor would have been if the obligation had been duly performed", III.–3:702 (General measure of damages), but the cost for the lessee will in most cases be substantially reduced compared with the ordinary payment of rent over a long period. These rules in combination work in fact as a right of termination, and in consumer contracts for lease the rules on remedies cannot be derogated from to the detriment of the consumer, cf. IV.B.–4:102 (Rules on remedies mandatory in consumer contract). In deciding whether or not it is reasonable to take the goods back, it must normally have some weight that the lease is a consumer lease. There may, however, be cases under these rules where a consumer will have to pay substantial amounts under a contract for lease when the lessee wants to terminate, for example for goods that are no longer needed or that the lessee for one reason or other cannot afford to lease any more. An additional rule allowing a consumer to terminate the lease for certain "important reasons" etc. has though not been deemed necessary. It would be contrary to the fundamental principles of freedom of contract and market mechanisms to try to eliminate all risks and all liability involved in most contracts. Terms concerning the lease period and the right to terminate the lease are often decisive with regard to the rent paid. A higher rent can in some cases be the "insurance premium" that must be paid for the right to terminate the contractual relationship early. Rules on extraordinary

termination should not distort this type of ordinary risk distribution in a contract, even where the lessee is a consumer.

Automatic prolongation etc. It may be agreed by the parties that a contract for lease for a fixed period will be prolonged for a new fixed period unless the lessee indicates otherwise within a certain deadline. If this deadline is very early, and there is no requirement that the lessee be reminded of the deadline, it may happen that the lessee does not react in time, with the result that the lease period is prolonged for a fixed period. Clauses of this kind are included in the “grey list” of terms that may be unfair under II.–9:411 (Terms which are presumed to be unfair in contracts between a business and a consumer) paragraph (10(h)). See also the Unfair Terms Directive (93/13). The protection given by the general principles on unfair terms are deemed sufficient, and no provision covering such clauses is included in this Part of Book IV.

Consumer credit and right to terminate lease. The Consumer Credit Directive (87/102) applies to “hiring agreements” where “these provide that the title will pass ultimately to the hirer” (article 2(1)(b)). Under the Directive the consumer has a right to “discharge his obligations under a credit agreement before the time fixed by the agreement” and, in this event and according to national law, “shall be entitled to an equitable reduction in the total cost of the credit” (article 8). It is explained in Comment G14 to IV.B.–1:101 (Lease of goods) that contracts for lease where the parties have agreed that ownership is to pass to the lessee are covered by the definition of contracts for sale and fall outside the scope of application of this Part of Book IV. A rule corresponding to article 8 of the Consumer Credit Directive is thus not included here.

IV.B.–2:103: Tacit prolongation

- (1) A lease period is prolonged for an indefinite period if:
 - (a) the lessee, with the lessor’s knowledge, has continued to use the goods after the expiry of the lease period;*
 - (b) the use has continued for a period equal to that required for an effective notice of termination; and*
 - (c) the circumstances are not inconsistent with the tacit consent of both parties to such prolongation.**
- (2) Either party can prevent tacit prolongation by giving notice to the other before tacit prolongation takes effect. The notice need only indicate that the party regards the lease period as having expired on the expiry date.*
- (3) Where the lease period is prolonged under this Article, the period during which the contract of lease has effect is also prolonged accordingly. The other terms of the contract are not changed by the prolongation.*
- (4) Notwithstanding the second sentence of paragraph (3), where the rent prior to prolongation was calculated so as to take into account amortisation of the cost of the*

goods by the lessee, the rent payable following prolongation is limited to what is reasonable having regard to the amount already paid.

(5) In the case of a consumer contract for the lease of goods the parties may not, to the detriment of the consumer, exclude the application of paragraph (4) or derogate from or vary its effects.

(6) Prolongation under this Article does not increase or extend security rights provided by third parties.

COMMENTS

A. Prolongation of the lease period

Explicit and tacit prolongation. Sometimes the lessee continues to use the leased goods after the expiry of the lease period, without objections from the lessor. This may be a mere non-performance of the lessee's obligation to return the goods to the lessor, giving rise to remedies on the part of the lessor. However, the situation might also be such that both parties intend to prolong the lease period: the lessee wishes to use the goods, and the lessor welcomes extra revenue from goods that are not needed for other purposes for the time being. A prolongation may of course be expressed in a new agreement, comprising explicit terms as to the length of the new lease period, the rent to be paid etc. Sometimes the parties explicitly agree that the lease period is to be prolonged, without saying for how long or on what terms. In still other cases it follows from the circumstances that each party has reason to believe that the other party agrees to a prolongation of the lease period. This "tacit" prolongation is in principle nothing more than what follows from general law on the conclusion of contracts (see II.-4:102 (How intention is determined)). However, supplementary rules are needed as it is not always clear *what* amounts to tacit prolongation (what circumstances may give the party reason to believe that the period is prolonged), and neither is it necessarily obvious on what *terms* the lease period is prolonged. Supplementary rules of this kind are "objective" law and do not presuppose an examination of what was meant or believed by the parties in each case. Such rules are found in this Article.

B. Tacit prolongation

Overview. Paragraph (1) of the present Article provides that the lease period is prolonged by tacit consent for an indefinite period if the lessee continues to use the goods for a period equivalent to the period of notice required for termination and the lessor has knowledge of this use. However, there is no prolongation if, in the meantime, either party gives notice that the lease period is regarded as expired (paragraph (2)). It is also sufficient to show that other circumstances are not consistent with tacit consent to a prolongation of the lease. If, based on this rule, the lease period is prolonged, the period during which the contract has effect is prolonged correspondingly with other terms unchanged (paragraph (3)). This means, for instance, that the rent for the prolonged period depends on the earlier terms. There are two exceptions: the rent should not be unreasonable, considering the amount already paid, if the original rent was calculated so as to amortise the cost of the goods (paragraph (4)), and security rights provided by third

parties should not be increased or extended (paragraph (6)). Both parties are bound to perform until the lease period is terminated by agreement or by one party giving notice of termination.

Non-mandatory character. The parties may agree that the rules on tacit prolongation are not to apply to their contract. This is an alternative in cases in which the parties know from the beginning that prolongation will not be an issue. In other cases both parties may want to have supplementary rules on tacit prolongation even if expiry of the lease period on a certain day or at a certain hour is foreseen as the normal development of the contract. The rule in paragraph (4) on unreasonable rent after prolongation of certain contracts cannot be derogated from to the detriment of the consumer in a consumer contract for lease.

No exception for consumer leases. Rules on tacit prolongation should apply to consumer contracts for lease as well as other contracts for lease. This is obvious in so far as the rules work in favour of the consumer. However, even where the effect of the rules is such that the lessee is bound by the tacit prolongation, this will normally be no excessive burden on the consumer, as the contract may be brought to an end by giving notice.

C. Prerequisites of tacit prolongation

Continued use. The first prerequisite for tacit prolongation is that the lessee continues to use the goods after expiry of the lease period. In most cases it will suffice that the lessee has not performed the obligation to return the goods to the lessor; it is not normally necessary that the lessee make active use of the goods. The circumstances may show, however, that the lessee means to make the goods available for the lessor to collect, whether based on a correct understanding of the contract or not. If this is the case, there is no tacit prolongation (see sub-paragraph (c)).

Lease period has expired. It is continued use after expiry of the ordinary lease period that leads to prolongation. In most cases it will be the expiry of a definite lease period, but it can also be, albeit less practical, expiry of the lease period as a consequence of a notice of termination. In the latter case, the circumstances will normally be inconsistent with consent to prolongation.

Length of continued use. Prolongation will not be the effect unless the continued use lasts for a period equal to the period of notice required to terminate the lease period. If the ordinary lease period expires on a fixed date, as will often be the case here, the period of notice required for termination will normally not be specified in the contract, since the contractual relationship is not intended to be terminable by notice. The relevant period of continued use is then what is reasonable (IV.B.-2:102 (End of lease period) paragraph (3)). The period of notice required to terminate the lease period, whether determinable from the contract or reasonable given the kind of goods, purpose of the lease etc., normally reflects the time required by the parties to prepare to return the goods on the one

hand and to accept return and find alternatives on the other. It is realistic to expect reactions to continued use within the same period of time.

Lessor's knowledge. Continued use without the lessor's knowledge will not lead to prolongation of the lease period. This corresponds to one of the underlying ideas of the rules on tacit prolongation, namely to clarify what circumstances should typically be regarded as giving one party reason to believe that the other tacitly consents to prolongation. The lessee will sometimes encounter difficulties in proving that the lessor knew of the continued use, as it is not a question of what the lessor *ought to* have known or could reasonably be expected to have known. The lessee may have an obligation for example to leave the goods at an agreed place to be picked up by the lessor, and the lessor may have believed that the goods were there, without having checked. Such cases must be decided on the basis of ordinary rules on proof and probability. The lessor's lack of knowledge may admittedly be caused by circumstances that are not apparent to the lessee, and this could be seen as a deviation from the principle, in II.-4:102 (How intention is determined), that the intention of a party is "to be determined from the party's statements or conduct as they were reasonably understood by the other party". The lessee's interests must, however, be balanced against the lessor's interests, the situation arising as it does through non-performance of the lessee's obligation to return the goods. Any doubts on the part of the lessee can normally be cleared with a simple inquiry addressed to the lessor.

Circumstances not inconsistent with consent. Prolongation as an effect of continued use of the goods is based on the presumption of the other party's consent, and prolongation will not result if the circumstances are inconsistent with such consent.

Illustration 1

When A leased B's digger for 20 days at a daily rate, A was informed that B needed the machine for B's own purposes immediately after this period. At the end of the period, A by e-mail apologises that the digger will be returned some days late. Even if B does not answer this message, continued use for some days will not lead to prolongation, as the combination of A's knowledge of B's plans for the machine and A's own explanation concerning the continued use shows that consent cannot be presumed.

Notice preventing prolongation. If notice is given according to paragraph (2) of the present Article, this will always prevent prolongation of the lease period. The provision makes it clear that such notice is a circumstance that is always inconsistent with the party's tacit consent. Notice must be given before tacit prolongation takes effect according to paragraph (1) and no earlier than expiry of the lease period (cf. the words "the lease ... period having expired" in the second sentence of paragraph (2)). There are no formal requirements concerning the notice and it may be given in writing or in any other form. The notice must make it clear that the party regards the lease period as having expired. A notice with this content, given at this time, always prevents tacit prolongation according to this provision. However, it should be borne in mind that any other notice, for

example given before expiry of the lease period or with less explicit wording, may perfectly well be regarded as a circumstance that prevents tacit prolongation because it is inconsistent with consent.

D. Effects of tacit prolongation

Prolongation for an indefinite period. The lease period is prolonged for an indefinite period, implying that the lease period cannot be terminated unilaterally without notice of termination being given, with effect after an appropriate period of time. This implies that rent must be paid for this period even if the lessee wishes to return the goods earlier and that the lessor has no right to have the goods returned immediately. The rule also implies that the lease period is *not* prolonged (or renewed) for a period of the same length as the original period, unless otherwise specified in the contract.

Prolongation takes effect from expiry. The prolongation is seen as an unbroken continuation of the original lease period. This means that there is an intermediate period where continued use will be treated as non-performance of the lessee's obligations if the lease period is *not* prolonged, but as ordinary use if prolongation takes effect.

The contract is prolonged accordingly. The continued use of the goods is based on the same contract as the former use. It is not a new contract. This also implies that the terms of the contract are unchanged, except for the terms concerning the lease period (and two exceptions that will be explained in the following paragraphs). The rent to be paid depends on the contract. Where the rent is set at a fixed amount per week, month etc., the same amount must be paid after prolongation of the lease period. In other cases there may be a regulation clause, e.g. giving the parties a right to index regulation each year. Such a clause will also be effective after prolongation.

Exception where the cost of the goods is already amortised. For some contracts, the rent is calculated so as to take into account the amortisation of the cost of the goods during the agreed lease period. These contracts are often three-party transactions involving a lessor, a lessee and a supplier of goods, where the lessor is a financial institution. However, the rent may also be calculated in this way in some two-party contracts. The contract may stipulate that the lessee has an option to buy the goods at the end of the lease period or a right to prolong the lease period at a substantially reduced rent. Where prolongation – or the terms of such prolongation – is not regulated by the individual contract, the rent for the prolonged lease period should not be unreasonable, given the amount already paid. In most cases this implies a substantial reduction in rent if the whole cost of the goods has already been paid. This rule is mandatory, in the sense that it cannot be derogated from to the detriment of a consumer in a consumer contract for lease (paragraph (5)).

No increase or extension of security rights. The present provision applies to the relationship between lessor and lessee and has no direct effect against third parties, for example an individual having provided a personal or a proprietary security right for the

payment of rent (paragraph (4)). Whether or not the security right is prolonged will depend on the terms of the security contract. If the security right is not prolonged, the lessee may be under an obligation to establish a new security.

CHAPTER 3: OBLIGATIONS OF THE LESSOR

IV.B.–3:101: Availability of the goods

(1) The lessor must make the goods available for the lessee's use at the start of the lease period and at the place determined by III.–2:101 (Place of performance).

(2) Notwithstanding the rule in the previous paragraph, the lessor must make the goods available for the lessee's use at the lessee's place of business or, as the case may be, at the lessee's habitual residence if the lessor, on the specifications of the lessee, acquires the goods from a supplier selected by the lessee.

(3) The seller must ensure that the goods remain available for the lessee's use throughout the lease period, free from any right or claim of a third party which prevents or is otherwise likely to interfere with the lessee's use of the goods in accordance with the contract.

(4) The lessor's obligations when the goods are lost or damaged during the lease period are regulated by IV.B.–3:104 (Conformity of the goods during the lease period).

COMMENTS

A. General

Characteristic obligations. Under a lease contract, the lessor makes goods available temporarily for the lessee's use against remuneration. The lessee's use typically implies physical control of the goods. Further, the goods must normally be returned to the lessor at the end of the lease period. As the contract is made for a period of time, questions arise concerning maintenance of the goods and repairs during this period. To the extent that the goods are not to deteriorate, the obligation to maintain and repair the goods must be borne by one of the parties or distributed between them. All this means that the lessor typically has obligations concerning (1) the availability of the goods at the start of the lease period, (2) the availability of the goods during the lease period, (3) the conformity of the goods at the start of the lease period, (4) the conformity of the goods during the lease period to the extent that this is not a part of the lessee's obligations, and (5) the return of the goods at the end of the lease period. In the present Article, availability of the goods at the start of the lease period and during the lease period are dealt with.

B. Time of performance

Start of the lease period. The lessor must make the goods available at the start of the lease period. The time at which the lease period starts may be determined from IV.B.–2:101 (Start of lease period). In the situations dealt with in paragraph (1) of that Article

the lease period starts even if the goods are not available to the lessee at the relevant point in time, or the lessee has not accepted the goods. These are questions of non-performance of the lessor's or the lessee's obligations. Where the lessee has taken control of the goods earlier than the time that would follow from IV.B.-2:101 (Start of lease period) paragraph (1), the lease period starts on acceptance of the goods (see paragraph (2) of that Article).

C. Place of performance

Reference made to general rules. The first paragraph of the present article refers to III.-2:101 (Place of performance). This reference is made only for clarity's sake.

Place of performance in lease contracts. The place of performance is often agreed upon expressly by the parties or can be determined from the agreed terms. If this is not the case, it is stated in III.-2:101 (Place of performance) that the place of performance should be the debtor's – that is the lessor's – place of business at the time of conclusion of the contract. If the lessor has more than one place of business, performance is to take place at the one that “has the closest relationship to the obligation”. In lease contracts, the relevant place of business will often be the place where it is most convenient for the lessee to pick up the goods, provided that the lessor's business at that place includes leasing activities.

Illustration 1

A lessee orders by telephone a car to be leased for one week in Rome. The lessor has several places of business in Rome, and the car is ordered through a general office serving all these places of business. If the lessee e.g. arrives in Rome by aeroplane, and this is made known to the lessor, one may presume that the relevant place of business is the one at the airport of arrival. If the lessee, for example, is resident in Rome, one may presume that the relevant place of business is the one located nearest the habitual residence of the lessee.

Goods acquired from a supplier selected by the lessee. The rule in paragraph (2) applies to situations in which the lessor acquires the goods on the lessee's specifications from a supplier selected by the lessee. Typically, these are contracts of a kind often referred to as “financial leases”. The goods are normally not brought to the lessor's place at all in these situations, and the general rule in III.-2:101 (Place of performance) would not be the best one. The parties may agree that the goods are made available for the lessee at the supplier's place. However, as the default rules of this Part of Book IV deal only with the contractual relationship between lessor and lessee, the fall-back rule for these contracts should be that the goods are made available at the lessee's place of business.

D. Availability of the goods

Availability at the start of the lease period. Normally, the contract requires that the lessee obtain physical control of the leased goods. The lessor must do what is needed to enable the lessee to obtain such control and the lessee must co-operate by accepting the goods. In this respect there is a parallel to contracts for the sale of goods. A simple

handing over of the goods is illustrative: the lessor offers the goods and the lessee accepts them at once. Control over the goods may also be transferred by giving the lessee a key or a code; the goods may be made available by the lessor at some agreed place for the lessee to pick up; the goods may be transported by an independent carrier who is instructed to deliver the goods to the lessee, perhaps against documents made available by the lessor; etc. As use of the goods is the purpose of the lease contract, and as the lessor will still be the owner of the goods, at least during the lease period, there is no need to regulate situations where the goods are to remain in the hands of the lessor. It could be, however, that the lessee already has physical control over the goods at the start of the lease period, as is occasionally the case in a sale.

Acceptance by employees etc. The goods may be accepted by someone on behalf of the lessee, typically by the lessee's employees. Depending on the agreement and the circumstances, the goods must also be regarded as made available for the lessee where they are given directly to a sub-lessee. It has not been found necessary to regulate explicitly this special situation.

Availability during the lease period. The lessor's obligations also include keeping the goods available for the lessee's use throughout the lease period. This normally implies that it will amount to non-performance if the lessor makes use of the goods for the lessor's own purposes or lets third parties use the goods if such use hinders the lessee's use in accordance with the contract. Further, it will be non-performance if the lessor sells or otherwise disposes of the goods if such disposition collides with the lessee's use. Where the rights of the lessor's creditors affect the lessee's use, this also amounts to non-performance by the lessor. These observations relate to the contract between lessor and lessee. The extent to which the lessee's rights have priority over creditors' and other third parties' rights in the goods will be commented upon in Chapter 7.

E. "Risk"

Availability and conformity. Normally, the lessor has not only an obligation to keep the goods available for the lessee, in the sense that the lessor's dispositions and personal use of the goods must not interfere with the lessee's use according to the contract (cf. the preceding paragraph), but also an obligation to keep the goods in conformity with the contract by performing maintenance and repairs. The latter obligation is regulated by IV.B.-3:104 (Conformity of the goods during the lease period). This obligation includes repair of goods that are damaged by chance. If the damage is total – the goods are "lost" – it may be that the lessee has no right to enforce performance, cf. III.-3:302 (Non-monetary obligations), but other remedies for non-performance may still be available. Theft of the goods should be dealt with in the same way as total loss; theft is not a question of a third party's right in the goods. One could ask if the goods are "available" to the lessee if they are totally damaged or lost. To make it clear that damage to or loss of the goods is dealt with as a question of non-conformity and not as a question of availability, a reference is made in the fourth paragraph of the present Article to IV.B.-3:104 (Conformity of the goods during the lease period). The difference is important in particular in contracts where the lessee has the full burden of maintenance and repairs, by

contract or by law. In such contracts, damage or loss will not lead to non-performance of the lessor's obligation to keep the goods in conformity with the contract, while interference with the lessee's use caused by third party rights or by the lessor's dispositions or personal use of the goods is still non-performance of the obligation to keep the goods available.

No passing of risk. For sales, there are rules on "passing of risk", including an explanation of "risk" in IV.A-5:101 (Effect of passing of risk): "Loss of, or damage to, the goods after the risk has passed to the buyer does not discharge the buyer from the obligation to pay the price, unless the loss or damage is due to an act or omission of the seller." Corresponding rules are not needed for lease contracts. Damage to or loss of the goods is dealt with as a question of non-conformity, cf. the preceding paragraph. It would be incongruous to regulate the consequences for rent payment independently of other remedies for non-performance. See also Comment B to IV.B.-5:104 (Handling the goods in accordance with the contract) on "risk" and the lessee's obligation to return the goods.

F. Non-availability due to need for repairs by lessor etc.

No exception for repairs etc. The lessor is in many cases obliged to carry out repairs and maintenance work on the goods during the lease period. The lessor also has a right to perform certain actions with regard to the goods, whether or not this is part of the lessor's obligation. The lessee's obligation to tolerate such measures is regulated in IV.B.-5:108 (Repairs and inspections of the lessor). The lessor's work on the goods may affect the lessee's use, and the goods may even be totally unavailable for the lessee while the work takes place. This is non-performance of the lessor's obligation to keep the goods available for the lessee's use. At first sight this can seem inconsequent: actions that the lessor has a right to take, result in non-performance, i.e. non-availability. The explanation is found in the definition of "non-performance". "Non-performance" covers any failure to perform, for whatever cause. However, the remedies available to the lessee will vary according to the cause of the non-performance. If repairs are necessary due to non-performance of the lessee's obligations, e.g. the obligation of care, the lessee cannot seek a remedy in the courts with regard to the consequent suspension of availability, cf. III.-3:101 (Remedies available) paragraph (3) (creditor may not resort to remedies "to the extent that the creditor caused the debtor's non-performance"). If, on the other hand, the non-availability is made necessary for other reasons, the lessee has a right to rent reduction, withholding of rent, damages as the case may be, and even termination should the non-performance be fundamental. Ordinary maintenance by the lessor, typically made necessary by accidents or normal use, will give the lessee a right to rent reduction – a remedy in line with the purpose of balancing the performances of the parties – but not to damages, as these measures cannot be avoided.

Illustration 2

A leased washing machine breaks down and must be taken to the lessor's premises to be repaired. The repairs take one week. The washing machine is old and the breakdown was caused by normal deterioration. The lessee may claim a reduction in the rent for one week but not damages, as the repairs could not be avoided.

Illustration 3

The facts are the same as in Illustration 2, except that the work takes three weeks because the lessor carelessly damaged other parts of the machine while repairing it. The lessee may claim a reduction in the rent for three weeks and damages covering expenses for the use of laundrettes during the two last weeks.

Illustration 4

The facts are the same as in Illustration 2, except that the breakdown was caused by the lessee's careless use of the machine. No remedies are available to the lessee with regard to the unavailability of the machine.

G. Third parties' rights or claims

Rights or claims that interfere with the lessee's use. The lessee's use must not be affected by third parties' rights. Some third party rights will not affect the lessee's use of the goods at all. A third party's security right will typically not affect the use as long as the lessor is not in a position where the security right becomes effective. This is different in contracts for sale, where the buyer does not have to tolerate any rights of this kind. If the lessor was not the owner of the goods and had no right to enter into a lease contract, the true owner's right will typically affect the lessee's use. Whether a later sale or a second lease of the same goods will affect the lessee's use, depends on the rules on priority of the lessee's rights over third parties' rights. To what extent the lessee must accept transfer of ownership, when the use is not affected, is dealt with in IV.B.–7:101 (Change in ownership and substitution of lessor).

Rights or claims that are likely to interfere with the lessee's use. The existence of a third party right that is likely to interfere with the lessee's use amounts to non-performance by the lessor. The lessee does not have to wait until the goods are in fact taken away. A security right can create a threat to the lessee's use if the lessor becomes insolvent or the creditors have taken steps to utilise the security right. Also a third party claim that is contested by the lessor may interfere with or threaten to interfere with the lessee's use. It will depend on the circumstances whether this kind of claim is sufficiently grounded to create a threat to the lessee's use. Allegations that are clearly unjustified are irrelevant. The lessee should not, however, be obliged to tolerate being involved in disputes between the lessor and third parties.

H. Contract and default rules

Non-mandatory rules. The parties may derogate from the provisions of the present Chapter unless otherwise provided. In normal situations the parties agree amongst themselves the basic elements of the contract: which object is to be leased, for how long and at what price. Often the parties also specify the required quantity and quality of the goods, where and when the goods are to be delivered, the distribution of obligations concerning maintenance and repairs etc. The rules of the present Chapter are merely supplementary in so far as they do not apply to issues sufficiently regulated by the parties. At the same time the rules of the present Chapter are objective rules applicable to

the contract for lease – in the supplementary fashion just described – without any act of inclusion or acceptance and independently of the parties’ will.

Consumer leases. Consumer protection rules may not normally be derogated from by the parties to the detriment of the consumer. On the other hand, the parties are in most cases free to decide whether or not to enter into a contract and to agree on what is to be leased, when, for how long and at what price, cf. Comment A4 to IV.B.–1:102 (Consumer contract for the lease of goods). It is specified in IV.B.–3:106 (Limits on derogation from conformity rights in a consumer contract for lease), however, that the parties may not describe the goods in a way that it is, in real terms, a derogation from the lessor’s obligation to ensure that the goods conform to the contract. See Comments to that Article.

IV.B.–3:102: Conformity with the contract at the start of the lease period

(1) The lessor must ensure that the goods conform with the contract at the start of the lease period.

(2) The goods do not conform with the contract unless they:

(a) are of the quantity, quality and description required by the terms agreed by the parties;

(b) are contained or packaged in the manner required by the terms agreed by the parties;

(c) are supplied along with any accessories, installation instructions or other instructions required by the terms agreed by the parties; and

(d) comply with the following Article .

COMMENTS

A. Conformity at the start of and throughout the lease period

Conformity. The condition of the goods regarding quality and quantity is normally a crucial issue in any lease contract. The lessee’s use of the goods and the benefits gained by this use depend heavily on the condition of the goods. The word “conformity”, together with its antonym “lack of conformity”, is used to denote the relationship between the lessee’s justified expectations under the contract and the factual state of the goods. The condition of the goods, in terms of both quality and quantity, can be determined by the parties in their individual agreement. Default rules on conformity of the goods at the start of the lease period are found in the present and the following Article. The rules are parallel to the rules for contracts for sale (Book IV.A).

Distinguishing conformity at the start of the lease period and during the lease period. The lessor typically has obligations concerning the condition of the goods both at the start of the lease period and during the lease period. This is a significant difference in comparison with sales contracts, where conformity as a rule is established upon

delivery (the time when risk passes). One might ask whether it is necessary to distinguish between the lessor's obligation concerning conformity at the start of the lease period and the obligation concerning conformity during the lease period. A distinction should be made for at least two reasons. First, the requirements concerning the condition of the goods are normally not exactly the same during the lease period as they are at the start of the lease period. This is obvious in contracts where the obligation to repair and maintain the goods is shared between the parties. Even where the lessor is obliged to keep the goods in the original condition throughout the lease period, the lessee must normally tolerate some discrepancies due to ordinary wear and tear. Second, the remedies for non-performance can be influenced by differences in factual situations: during the lease period it is quite possible that non-conformity is caused by factors beyond the lessor's control and even by the lessee's own non-performance.

B. Conformity at the start of the lease period

Individual agreement and default rules. The parties normally agree at least on the basic requirements of quantity and quality of the leased goods. In some cases the goods are described in great detail, either directly in one or more contract documents or by referring to certain technical standards etc. In other cases the goods are not described at all beyond the identification of a certain thing or of goods of a certain kind. It may, however, be possible to determine the quantity and quality of the goods to some extent by taking into consideration the lessor's knowledge of the lessee's intended use of the goods and other circumstances. Sometimes one has to look at default rules – objective law regulating the contract where the parties have not agreed otherwise. The default rules may be more or less specific. In their most general form the default rules refer to reasonableness and other abstract principles. For lease contracts, the present Article refers to the individual agreement, while some default rules are found in the next Article, even if referred to already in the present Article. In addition, the general rules in Book II and Book III apply. It should be noted that it is not necessary – and not always possible – to distinguish strictly between individual requirements and requirements in default rules.

Illustration 1

Lessee A agrees to lease a computer that lessor B will build based on the specifications of A's IT expert. When the computer is delivered, A discovers that it has insufficient capacity for the intended use. As the computer has been built in accordance with the specifications, it conforms to the contract and there is no non-performance.

Illustration 2

The construction business enterprise A agrees with B, a professional provider of construction equipment, to lease a building fence for a particular building site. Even if the contract has no specifications, it can be determined from the contract that B must deliver a fence that is long enough for this building site, and as B knows that the site is located in the centre of the town, it must conform to public requirements regarding traffic, pedestrians etc.

Elements of agreed condition of the goods. The present Article, which has a parallel for sales contracts in IV.A–2:301 (Conformity with the contract), describes the elements of the agreed condition of the goods. The expression “quality, quantity and description”, cf. paragraph (2)(a), is wide enough to cover all aspects of the agreement concerning the condition of the goods. Paragraph (2)(b) specifies that the goods must be contained and packaged in the manner required by the contract. These requirements may be relevant for contracts for lease as well as for contracts for sale, typically when the lessee picks up the goods and trusts that they are protected by proper packaging (cf. Illustration 3 to the following Article concerning default rules). Accessories and instructions are dealt with under paragraph (2)(c); these elements may be specified in the parties’ agreement. Paragraph (2)(d) refers to the default rules in the following Article. This means that, technically, the present Article includes requirements based both on the individual agreement and the default rules.

No provision concerning specifications etc. For sales contracts, IV.A–3:102 (Determination of form, measurement or other features) deals with situations in which the buyer is to determine the form, measurements and other features of the goods and fails to provide such specifications. Under certain conditions, the specifications may be made by the seller and these specifications will then be binding for the buyer. It has not been found necessary to include a corresponding provision for leases, as the situation is less practical here than it is for sales contracts.

Relevant point in time for establishing conformity. This Article fixes the relevant point in time for establishing conformity with the contract, namely the start of the lease period. Further, it follows from the Article that the condition of the goods *prior* to the start of the lease period, for example at the time when the agreement was concluded, is *not* relevant for establishing conformity with the contract – that is, of course, unless the parties have agreed otherwise. It is explained in Comment A that the distinction between requirements at this point in time and the requirements for the subsequent lease period may be of importance. A lack of conformity which was present at the start of the lease period, but which was unknown to both parties (“hidden defect”), is treated as a lack of conformity at the start of the lease period even if the effects become apparent only later. Thus, this may be non-performance of the lessor’s obligations even in a contract placing the obligation of maintenance on the lessee.

Agreements on quality etc. compared with exemption clauses. Rules on conformity and rules on remedies for non-conformity are closely related. The present Article obliges the lessor to ensure that the goods meet the requirements of the contract to be in conformity with the contract. Lack of conformity is non-performance of the lessor’s obligations. This could also be put another way: the lessee is entitled to remedies for non-performance if the goods do not meet the requirements of the contract. The model chosen in this Part of Book IV, operating with conformity as the link between the requirements of the contract on one hand and remedies on the other, is the same as in other Parts of Book IV and in many national systems. Sometimes, it may be difficult to distinguish between an exemption clause and a description of the goods. If the goods are described

only vaguely, or if the lessor is explicitly given a wide range of choice concerning what kind of goods are to be leased and the quality of the goods, this may have the same effect as a contract term limiting the lessor's liability. As a rule, this Part of Book IV is non-mandatory, even where remedies for non-performance are concerned, and the distinction between an exemption clause and a description is not important. In consumer contracts, however, rules on remedies are designed to be mandatory. In these cases, a line must be drawn between description of the goods and derogation clauses. This is a problem common to several types of contract; it is hardly possible to give general guidelines as to how the line should be drawn. Further, giving the lessor a wide range of choice in defining the quality and quantity of the goods may be regarded as an unfair term, cf. Book II, Chapter 9, Section 4 and the EC Directive on Unfair Terms in Consumer Contracts (93/13) with annex.

Illustration 3

Lessor A and lessee B agree that B will, starting next month, lease a car of a certain brand and model with ten seats. However, it is a term of the contract that B is to have no remedies if the car provided does not conform to the contract. If the contract is a consumer contract, this is an invalid exemption clause, cf. IV.B.-4:102 (Rules on remedies mandatory in consumer contract).

Illustration 4

The situation is the same as in Illustration 1, but this time there is a term allowing the lessor to provide a car of another brand or model or with fewer seats. Depending on the circumstances (the lessee's needs, the planned use of the car etc.) this term may be treated as an exemption clause which is invalid in a consumer contract, cf. IV.B.-3:106 (Limits on derogation from conformity rights in a consumer contract for lease).

NOTES

See notes to following Article.

IV.B.-3:103: Fitness for purpose, qualities, packaging etc.

The goods do not conform with the contract unless they:

- (a) are fit for any particular purpose made known to the lessor at the time of the conclusion of the contract, except where the circumstances show that the lessee did not rely, or that it was unreasonable for the lessee to rely, on the lessor's skill and judgement;*
- (b) are fit for the purposes for which goods of the same description would ordinarily be used;*
- (c) possess the qualities of goods which the lessor held out to the lessee as a sample or model;*
- (d) are contained or packaged in the manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods;*

(e) are supplied along with such accessories, installation instructions or other instructions as the lessee could reasonably expect to receive; and
(f) possess such qualities and performance capabilities as the lessee may reasonably expect.

COMMENTS

A. Default rules on conformity

General. The present article has default rules that supplement the individual agreement regarding the condition of the goods at the start of the lease period. Some of the provisions are closely connected to the individual agreement (particular purpose, sample or model), while others are more general (fit for ordinary purposes). Corresponding rules on sales contracts are found in IV.A-2:302 (Fitness for purpose, qualities, packing etc.).

Fit for particular purposes. Where the lessee has leased the goods for particular purposes and the purposes are known to the lessor, the goods should be fit for these purposes unless otherwise agreed. Often, the lessor is a business and the lessee is a person without any special knowledge of the kind of goods in question. The lessor is then expected to either supply goods fit for the purposes or else warn the lessee that the goods are not fit for the purposes. However, this applies only where the lessee may reasonably rely on the lessor's expertise. The lessee cannot rely on the lessor's expertise if the particular purposes are not sufficiently made known to the lessor. The situation may also be such that the lessor's knowledge of the lessee's purposes is not sufficiently detailed. The lessee is typically in a better position to know about the intended use of the goods. Further, it may be that the lessee has more expertise concerning the particular kind of goods than the lessor. If both the lessor and the lessee are amateurs, and the lessee has no reason to expect more, the lessee can consequently not rely on any expertise on the lessor's side.

Illustration 1

A leases a small car from B, in order to drive from Amsterdam to Brussels. This qualifies as ordinary use of a small car, and does not constitute a particular purpose. However, when driving back from Brussels to Amsterdam, A is to tow another car. The small car is not capable of towing another car. If A has made the towing purpose known to B, and B has not informed A to the contrary, the car is required by the contract to fulfil this purpose.

Fit for ordinary purposes. A more general rule is found in sub-paragraph (b): the goods must be fit for the purposes for which goods of the same kind would ordinarily be used. This is, together with sub-paragraph (f), a requirement of "ordinary standard". The basic requirement is that the goods can be used for their ordinary purpose. It must also be possible to obtain the normal benefit and results of use without extraordinary costs or difficulties. The goods must further comply with relevant legislation or other public or private requirements concerning for example safety. Technical standards etc. may be relevant. The provision refers to the ordinary purposes of use for goods of the "same

description”, irrespective of the actual contract. However, the reference to an ordinary standard must be seen in connection with the circumstances of the particular case. The requirements may vary according to the agreed rent, the agreed lease period, time available to prepare delivery, etc.

Sample or model. Where the lessor has held out a sample or a model prior to conclusion of the contract, the leased goods must normally conform to the quality of this sample or model, cf. sub-paragraph (c). The lessor may, however, have informed the lessee of differences to be expected, and the circumstances may also allow for certain discrepancies, e.g. a different colour.

Illustration 2

B leases a computer from A. The model demonstrated at the business premises of the lessor has a 19-inch screen, but the leased computer comes with a 15-inch screen. It does not conform to the contract, as the computer screen should be equal to that demonstrated at the premises of the lessor.

Packaging etc. The goods must be packaged or contained in an adequate way, cf. sub-paragraph (d). This may be of importance for the lessee in connection with transport, storage and return of the goods. If goods of the relevant kind are normally contained or packaged in a certain manner the lessor has an obligation to make the goods available contained or packed in this manner – or to a higher standard. This applies even if there are terms in the individual agreement regarding packaging. When there is no standard manner of containing or packing the goods, the standard required to preserve and protect the goods is decisive. These rules are of particular importance for contracts in which the burden of maintenance falls on the lessee.

Illustration 3

When the lessee arrives at home with the 48 crystal glasses leased for a wedding party, six of them are broken. The glasses were transported in the lessee’s car with normal care taken. No instructions for transport were given. The glasses should have been packed so as to protect them from breakage in normal conditions of transport. The glasses did not conform to the contract.

Accessories and instructions. The accessories, instructions etc. which the lessee may reasonably expect, cf. sub-paragraph (e), depend on the circumstances. Instructions for maintenance may be needed if the goods are leased for a long period, but not if the goods are leased just for a few days or hours. The accessories necessary for normal use and safety must sometimes come with the goods, while the circumstances may indicate that accessories required for the lessee’s particular purposes must be provided by the lessee.

Illustration 4

A copier is leased for two years and is installed by the lessor. The lessee can expect that the first toner cartridge is in place – but not necessarily included in the agreed rent – so that the copier is ready for use. Subsequent replacements must be

ordered by the lessee. However, the situation may be different if the copier uses generic cartridges, not usually supplied by the lessor; in such cases it may be that the lessee cannot expect the copier to be installed with a cartridge.

Illustration 5

X leases a cabin cruiser for three weeks. The lessee can reasonably expect that there is a fire extinguisher on board when the boat is made available for the lessee's use.

What the lessee may reasonably expect. A general provision is included in sub-paragraph (f): the goods must possess such qualities and performance capabilities as the lessee may reasonably expect. This rule overlaps with several of the other rules of the present paragraph, but it expresses a general principle that may supplement the former limbs. Together with the rule in sub-paragraph (b), it expresses the requirement of "ordinary standard". The rule in sub-paragraph (f) is closely connected to the rule in II.–9:108 (Quality): if the quality cannot be determined from the terms agreed by the parties, from a rule of law or from usages or practices, "the quality required is the quality which the recipient could reasonably expect in the circumstances".

IV.B.–3:104: Conformity of the goods during the lease period

(1) The lessor must ensure that throughout the lease period, and subject to normal wear and tear, the goods:

- (a) remain of the quantity, quality and description required by the contract; and*
- (b) remain fit for the purposes of the lease, even where this requires modifications to the goods.*

(2) Paragraph (1) does not apply where the rent is calculated so as to take into account the amortisation of the cost of the goods by the lessee.

(3) Nothing in paragraph (1) affects the lessee's obligations under IV.B.–5:104 (Handling the goods in accordance with the contract) paragraph (1)(c).

COMMENTS

A. General

Models. Regarding the condition of the goods during the lease period, different models are possible: the lessor may be obliged, throughout the lease period, to keep the goods more or less in the same condition as that required at the start of the period. The opposite solution is to impose these obligations on the lessee. In principle, it could also be that neither party has obligations concerning maintenance and repairs, the situation then being that the lessee must tolerate deterioration or damage during the lease period and the lessor must accept the condition in which the goods are recovered at the end of the lease period. Intermediate solutions are more common: in such cases, the lessee must usually perform some maintenance and repair and the lessor must do the rest. The situations vary a lot.

Typically, the obligation of maintenance etc. may be borne by the lessor alone in contracts for very short periods (some hours or days), while – at the opposite end of the scale – all work is left to the lessee where the lease period covers the entire economic lifespan of the goods and the contract for lease in fact has the same function as a contract for sale. The present Chapter is based on a mixed model where the obligations regarding maintenance etc. are distributed between the parties. The rules must be accompanied by a test of reasonableness, taking into account the circumstances of each case. A particular rule is included for contracts where the rent is calculated so as to take into account the amortisation of the cost of the goods, i.e. the intention is that the goods are leased to only one lessee. In these cases, the lessor should have no obligation to repair or maintain the goods, cf. paragraph (2) and Comment C, second paragraph.

Conformity and availability. It is noted in Comment E to IV.B.–3:101 (Availability of the goods) that loss of or damage to the goods – including theft – is regarded as a question of conformity and dealt with in the present Article.

Repairs, maintenance, wear and tear, duty of care. Some activities are normally required to keep up the standard and functioning of leased goods. For most contracts for lease it is therefore necessary to establish, by individual agreement or by default rules, to what extent each of the parties – lessor and lessee – must carry the practical and economic burden of such activities. There exist a wide range of possible options. Use of a leased gold bracelet hardly involves any costs at all, even if the lease lasts for years, while use of a leased machine for heavy outdoor construction work may entail considerable costs each day. In national legislation, as in contracts for lease and in everyday language, different expressions are used – expressions which normally have no precise meaning. Roughly, ‘repairs’ typically denotes measures taken to re-establish the normal condition after some damage to the goods, breakdown of vital parts etc., while ‘maintenance’ typically refers to ordinary activities – often at certain intervals – that are necessary to avoid deterioration and damage. By ‘wear and tear’ is normally meant ordinary and often inevitable traces of use that are typical for most goods that are not new any more, even if they are treated with care and properly maintained. The latter expression is found in the present Article, while the expressions ‘repairs’ and ‘maintenance’ are not used or defined in the provision. The activities are described in a way which does not necessitate a clear distinction between ‘repairs’ and ‘maintenance’. It should also be noted that it is not always possible to distinguish an obligation of maintenance from the obligation to handle the goods with care or even from the daily operation of some devices. Necessary oiling of parts of a machine illustrates this as well. It is not necessary to distinguish between maintenance and care for the purposes of the present Article.

B. Lessor’s obligation

Obligation to keep the goods in the original condition. The starting point concerning the lessor’s obligations is found in the first paragraph of the present article: the lessor must ensure that the goods remain fit for the purpose and remain of the quality and quantity initially required. This means that the lessor must repair any damage to the

goods and do what is necessary to maintain the original standard and functioning of the goods – with the exceptions noted below. The lessee must accept that the lessor’s activities in this respect are likely to have some consequences for the normal use of the goods, cf. IV.B.–5:108 (Repairs and inspections of the lessor).

Fit for purposes – the dynamic aspect. At the start of the lease period the goods must normally be fit for the lessee’s particular purposes, if known to the lessor, and for the purposes for which goods of the same kind would ordinarily be used. Conformity during the lease period means that the goods remain fit for such purposes, even under changed circumstances. Typically, public security requirements may change during the lease period. Unless the parties have agreed otherwise, the lessor should be obliged to keep the goods fit for the relevant purposes. Sometimes this may imply repairs; in other cases the situation may be such that the goods can no longer be used at all.

Illustration 1

A farmer has leased a tractor for two years. After six months public safety requirements are amended, so that all farm tractors must now have a new type of steel frame protecting the driver. If the lessor will not – or cannot – install such a frame, this is non-performance of the obligation under the present Article.

Wear and tear. The lessee must accept normal wear and tear for the kind of goods in question. The meaning of this expression is dealt with in Comment A, last paragraph. Normal wear and tear will typically not affect the functioning of the goods at all or at least not significantly. An example might be scratches to the paintwork of a construction machine. Minor deteriorations occurring during the intervals between regular maintenance work can also be regarded as normal wear and tear.

Illustration 2

A pair of alpine skis is leased for the season. At the end of the season, the steel edges of the skis are not as sharp as they were at the beginning of the lease period, to some extent reducing their performance capabilities. The skis still conform to the contract as long as the use is not significantly affected.

Lessor’s obligation negatively defined. Besides tolerating normal wear and tear the lessee may also be obliged to perform some activities necessary to maintain the standard and functioning of the goods, cf. the third paragraph of the present article and comments below. In addition, the lessee must handle the goods with care and in some exceptional cases intervene to take care of the lessor’s interests, cf. IV.B.–5:104 (Handling the goods in accordance with the contract) and IV.B.–5:105 (Intervention to avoid danger or damage to the goods). Unless otherwise agreed, the lessee has no other obligations to repair or maintain the goods than those stated in these provisions. The exceptions to the lessor’s obligation to keep the goods in the same condition as they were in at the start of the lease period are thus exhaustive and the lessor’s obligation as stated in the first paragraph is negatively defined.

C. Lessee's obligation

General. The second and third paragraphs of the present article are formulated as exceptions to the lessor's obligation stated in the first paragraph. The first exception applies where the rent is calculated so as to take into account the amortisation of the cost of the goods, typically in a lease for financing purposes, cf, the following paragraph. The second and more general exception refers to the obligation of the lessee stated in IV.B.–5:104 (Handling the goods in accordance with the contract) paragraph (1) (c) to preserve the normal standard and functioning of the goods. The lessee's obligation – and the corresponding exception to the lessor's obligation – will be commented upon here.

Leases with full amortisation of the cost. In many cases, a contract for lease is more or less functionally equivalent to a contract for sale. This is typically the case where it is intended that the cost of the goods will be amortised through one lease contract, the lease period then regularly covering the entire expected economic lifespan of the goods. Important examples are three-party transactions of the type covered by the Unidroit Convention on International Financial Leasing. The lessor has the role of a financing party and acquires the goods on the lessee's specifications from a supplier chosen by the lessee. The lessor's ownership of the goods serves the purpose of securing the claim for full payment of the rent for the entire lease period. As the full interest in the quality and functioning of the goods is vested in the lessee, it is usual to leave all maintenance to the lessee. On the other hand, the lessor normally cannot allow the lessee to let the goods deteriorate, as the value of the goods during the lease period is important for the lessor's security interest in the goods. The lessee should, therefore, have a positive obligation to keep the goods in the condition they were in at the start of the lease period, subject to normal wear and tear for the kind of goods, cf. IV.B.–5:104 (Handling the goods in accordance with the contract) paragraph (2). These observations are relevant not only to the three-party transactions referred to, but also to two-party transactions, often quite similar to conditional sales, with the exception that it is not agreed that ownership will pass. The criterion for relieving the lessor of the obligation of maintenance etc. (second paragraph of the present Article) and for placing a corresponding burden on the lessee (IV.B.–5:104 (Handling the goods in accordance with the contract) paragraph (2)) should be the calculation of the rent, not whether it is a three-party or a two-party transaction. The formula chosen is amortisation of "the cost", meaning the total cost of the goods. Expressions like "the substantial part" of the cost (as the formula is in the Unidroit Convention) have been avoided as they are ambiguous (is more than half of the cost sufficient or must it be almost the total cost?). If the parties want to achieve the same regulation for a contract where only a part of the cost is amortised through rent payments (leases with "residual value" etc.) they must include this in their individual agreement. It should also be noted that the regulation in the second paragraph of the present Article and in IV.B.–5:104 (Handling the goods in accordance with the contract) paragraph (2) implies that the lessee will bear the "risk" in case of damage to the goods by chance, theft of the goods etc., as the lessor has no obligation to repair or replace the goods, cf. also IV.B.–3:101 (Availability of the goods) paragraph (4), and the lessee has a positive obligation to keep the goods in the condition they were in at the start of the lease period, subject to wear and tear.

Measures ordinarily to be expected. For lease contracts other than those discussed in the preceding paragraph, the lessee's obligation concerning maintenance etc. is defined in IV.B.–5:104 (Handling the goods in accordance with the contract) paragraph (1)(c), and a corresponding exception is included in the third paragraph of the present Article. The activities falling under the lessee's obligation include such measures as must ordinarily be expected to become necessary during the lease period. What is to be expected depends on the character of the goods, the intended use of the goods and the length of the lease period. Taking the lease of a car as an example, no measures are to be expected, apart from refilling with fuel, if an ordinary car is leased for a weekend. If the car is leased for several months or for years, on the other hand, ordinary service checks, change of oil etc. must be expected, perhaps even a change of tyres. Repairs, such as installing a new windscreen or replacing parts of the engine, are not to be expected even within the scope of a long lease period. The situation may be different where a machine or vehicle is leased for rough or taxing use over a period of some weeks – in such cases, even a change of parts may be a measure to be expected. Whether or not the measures must ordinarily be expected is decisive in each case. Statistics may show that there are defects now and then in goods of the kind leased and that repairs are necessary in such cases. These are not, however, measures that must ordinarily be expected. The same is true for accidental damage to the goods, cf. the windscreen example.

Preserving normal standard and functioning. The measures to be taken by the lessee are such measures as are necessary to preserve the normal standard and functioning of the goods. Upgrading and renewal of the goods are not covered by the lessee's obligation. Repairs made necessary by damage to the goods are not measures required to preserve the normal standard and functioning of the goods. Thus, these measures are normally excluded from the lessee's obligation as not ordinarily to be expected, cf. the preceding paragraph. It is irrelevant whether the damage is caused by a third party or by the lessee. In the latter case it may be that the lessor can claim damages, but the obligation to repair remains on the lessor's side.

Test of reasonableness. The measures referred to in IV.B.–5:104 (Handling the goods in accordance with the contract) paragraph (1)(c) and indirectly in the third paragraph of the present Article are only included in the lessee's obligation – and excluded from the lessor's obligation – to the extent that it is reasonable, taking into account the duration of the lease period, the purpose of the lease and the character of the goods. This test of reasonableness is required as a result of the wide spectrum of contracts covered by the provision. One example of the need for such a test might be a situation in which ordinary maintenance must be performed at certain intervals and the goods are leased just for short periods by subsequent lessees. Here it may be unreasonable to hold the particular lessee, at the time maintenance becomes due, responsible for the costs.

Co-operation with lessor. The lessee's obligations under IV.B.–5:104 (Handling the goods in accordance with the contract) paragraph (1)(c) may sometimes imply alterations to the goods that should not be made without consulting the lessor. As a rule, the lessee

has a right to do what is necessary under that provision. Should the situation be, however, that a reasonable lessee would understand that the lessor might have preferences concerning the measures to be taken, it follows from the lessee's general obligation of co-operation (III.-1:104 (Co-operation)) that the lessor must be consulted if possible.

IV.B.-3:105: Incorrect installation under a consumer contract for the lease of goods

Where, under a consumer contract for the lease of goods, the goods are incorrectly installed, any lack of conformity resulting from the incorrect installation is deemed to be a lack of conformity of the goods if:

- (a) the goods were installed by the lessor or under the lessor's responsibility; or*
- (b) the goods were intended to be installed by the consumer and the incorrect installation was due to shortcomings in the installation instructions.*

COMMENTS

A. Installation and lack of conformity

Overview. The purpose of this Article is to make the rules on lack of conformity applicable to situations where the goods are installed incorrectly after the goods have been made available to the lessee and the installation is done by the lessor or by the lessee according to the lessor's instructions. A parallel rule is found in the Consumer Sales Directive and in IV.A-2:204 (Incorrect installation in a consumer contract for sale). For lease contracts the rule will apply to situations where installation is done at the beginning of the lease period as well as situations where the installation is done later, typically in the course of repairs or improvements to the goods. "Installation" should be read in its broadest sense, as covering both assembly of the parts made available to the lessee, the fitting of the goods to other objects and subsequent adjustments (e.g. connecting a leased washing machine etc.) and the replacing or supplementing of parts.

Installation by the lessor. The installation may be done by the lessor or under the lessor's responsibility, for example where a safety seat is installed in a car or additional memory is installed on a leased computer, in both cases either at the beginning of the lease period or later on. If the installation is incorrect (the safety seat is not properly attached, the new memory does not function), this is deemed to be a lack of conformity under the contract, and the remedies for lack of conformity apply. There is then no need to discuss whether or not the installation should be seen as an "accessory" obligation, the non-performance of which would lead to consequences other than non-performance of the ordinary obligations under the contract. Normally, the negative effects caused by the installation are also to be dealt with under the rules on lack of conformity, as for example where ordinary car seats are torn up during installation of a safety seat or where additional memory installed on a computer causes a conflict with other functions.

Installation by the lessee. If installation is to be by the lessee, the lessor is normally not liable for incorrect installation. An exception is made under sub-paragraph (c) for

situations in which incorrect installation is due to shortcomings in the installation instructions. Instructions that should have been provided by the lessor may be totally lacking or the instructions may be incomplete or misleading. In the absence of this Article it might be argued that the lessor is liable only for damages. The Article applies even where someone else, for example a household member, a friend or a professional, performs the installation for the lessee, as long as the incorrect installation is a direct result of shortcomings in the installation instructions.

The installation must be under the contract. The present Article applies only where installation is done under the contract, either as an obligation on the lessor or as an intention that installation is to be by the lessee. If installation becomes necessary because of repairs that are part of the lessee's obligations under the actual contract or because of improvements initiated by the lessee (with or without the lessor's consent, as the case may be), general rules should apply even where the lessee engages the lessor to perform the work or where new parts are bought from the lessor with installation instructions. This should not be seen as non-performance of obligations under the lease contract.

IV.B.–3:106: Limits on derogation from conformity rights in a consumer contract for lease

In the case of a consumer contract for the lease of goods, any contractual term or agreement concluded with the lessor before a lack of conformity is brought to the lessor's attention which directly or indirectly waives or restricts the rights resulting from the lessor's obligation to ensure that the goods conform to the contract is not binding on the consumer.

COMMENTS

A. General

Mandatory rules in consumer contracts for lease. The parties to a consumer contract for lease are in most cases free to decide whether or not to enter into a contract and to agree on what is to be leased, when, for how long and at what price. On the other hand, the consumer's rights resulting from the lessor's non-performance may not, as a rule, be waived beforehand, cf. Comment A, the last paragraph to IV.B.–1:102 (Consumer contract for the lease of goods) and Comment B to IV.B.–3:102 (Conformity with the contract at the start of the lease period). The purpose of the present Article is to specify that derogation to the consumer's detriment cannot be achieved indirectly, for example by describing the goods in a way that it is, in real terms, a derogation from the lessor's obligation to ensure that the goods conform to the contract.

Illustration 1

X wishes to lease a suit for a wedding and contacts Y, a professional who leases wedding suits. The contract is concluded after X has seen a sample suit and measures have been taken. The contract includes a term in which the lessee accepts that size and colours may vary, depending on the availability of suits in

Y's shop on the relevant date. This term is not binding on X, as its effect is to waive the rights resulting from the lessor's obligation to ensure that the goods conform to the contract.

IV.B.–3:107: Obligations on return of the goods

The lessor must:

- (a) take all the steps which may reasonably be expected in order to enable the lessee to perform the obligation to return the goods; and*
- (b) accept return of the goods as required by the contract.*

COMMENTS

A. Separate obligation to take goods in return

Lessor's obligation. The lessor's obligation to accept the goods at the end of the lease period corresponds to the lessee's obligation to return the goods. The obligation implies for example informing the lessee of details concerning the place for return of the goods and accepting the goods. Normally, it is in the lessor's own interest to have the goods returned. Co-operating to make the performance of the lessee's obligation possible is, however, seen as an obligation in its own right, and if the lessor does not accept return of the goods, this amounts to non-performance on the lessor's side. It is not only in the lessor's interest that the goods are returned; it may be essential for the lessee as well to dispose of the goods and of the responsibility for keeping them. For environmental and security reasons goods should not normally be left unattended.

Right not to accept the goods? The situation may be that the lessee wishes to return goods that are not in the condition the lessor might expect, as a result of non-performance of the lessee's obligations of care and maintenance. The question of whether the lessor may refuse to accept the goods and resort instead to remedies for delay must be answered on the basis of general rules on non-performance and remedies. It has not been found necessary to deal with this issue in the present article.

B. Remedies

Remedies for non-performance. If the lessor fails to perform the obligation to accept the goods, general rules on remedies for non-performance apply. In this situation the practical remedy is damages for loss caused by the lessor's non-performance.

Protection of the goods etc. In addition to general rules on remedies for non-performance, III.–2:111 (Property not accepted) applies. This means that the lessee has obligations to protect and preserve the goods if the lessor does not accept them and further that the lessee may deposit, sell or dispose of the goods, as the case may be, and claim damages for loss incurred by such actions.

CHAPTER 4: REMEDIES OF THE LESSEE

IV.B.-4:101: Overview of remedies of lessee

If the lessor fails to perform an obligation under the contract, the lessee may be entitled, according to Book III, Chapter 3 and the rules of this Chapter:

- (a) to enforce specific performance of the obligation;*
- (b) to withhold performance of the reciprocal obligation;*
- (c) to terminate the lease;*
- (d) to reduce the rent;*
- (e) to damages and interest.*

COMMENTS

A. Overview

Relationship to the general rules in Book III. General rules in Book III, Chapter 3 on non-performance and remedies apply also to non-performance of obligations under a contract for the lease of goods. Some derogations or additions are needed due to the characteristic traits of lease contracts. In the present Article a general reference is made initially to Book III, Chapter 3, while derogations and additions are found in subsequent provisions. Rules already found in Book III, Chapter 3 are thus not repeated. Not all of these remedies are available in every case of non-performance of an obligation by the lessor. For example, termination of the lease will be available under Book III, Chapter 3, Section 5 only if the non-performance is fundamental. This is why the word “may” is used in opening words of the Article.

Lessee’s remedies only. The present Chapter deals with the lessee’s remedies only. Provisions on the lessor’s remedies for non-performance of the lessee’s obligations are found in Chapter 6.

Listing of remedies. The list of remedies in this Article is exhaustive, but the remedies are described in general terms, while more specific rules are found in Book III, Chapter 3 and in the subsequent provisions of this Chapter. The term “reduce the rent” is used instead of the more general term “reduce the price”, but the term “rent” is wide enough to cover any remuneration from the lessee, whether it is seen as an ordinary rent payment or a payment for additional services included in the contract. In the expression “terminate the lease” in sub-paragraph (c) the word “terminate” refers to termination in whole or in part and the word “lease” refers to the contractual relationship between the lessor and the lessee arising from the contract for lease (cf. III.-3:501 (Scope and definition) paragraph (2)).

B. Right to enforce performance

Enforce specific performance. It follows from III.–3:302 (Non-monetary obligations) that the creditor is entitled, subject to certain prerequisites, to enforce specific performance of the debtor’s non-monetary obligation, including the remedying free of charge of a performance that is not in conformity with the contract. A lessee has this right where the goods are not made available at all, where only some (or some part) of the goods is made available, where the quality of the goods does not conform to the contract, where third parties’ rights interfere with the lessee’s use of the goods, where the goods become unavailable for the lessee’s use during the lease period, and where the lessor does not accept the goods at the end of the lease period. The lessee may further be entitled to enforce specific performance of other obligations undertaken by the lessor in the individual contract. Specific performance may, depending on the circumstances, entail making available unique goods under the contract, replacing goods, repairing non-conforming goods, eliminating third party rights and accepting goods that are returned by the lessee.

Exceptions. There are several exceptions to the creditor’s right to enforce specific performance, cf. III.–3:302 (Non-monetary obligations) paragraphs (2) and (3). Specific performance cannot be enforced where performance would be unlawful or impossible, unreasonably burdensome or expensive, or of such a personal character that it would be unreasonable to enforce it. For lease contracts the exception of unreasonably burdensome performance holds particular interest as the leased goods still belong to the lessor and often will be returned at the end of the lease period for the lessor’s own use or for new lease contracts. The lessor may have good reasons to object to more or less irreversible modifications to the goods even where such modifications are not unreasonably expensive.

Illustration 1

X leases an antique bride’s crown to wear on her wedding day. The crown has been in the lessor Y’s family for centuries. By mistake, Y gives X incorrect information on the size of the crown, and it does not fit. This amounts to a lack of conformity under the contract, but the lessee is not entitled to have the crown altered, whether by the lessor or someone else, as it would be unreasonable to make changes to an heirloom like this, irrespective of any loss of economic value that might result from the change.

C. Right to withhold performance

General rules. According to III.–3:401 (Right to withhold performance of reciprocal obligation), a party who is to perform “at the same time as, or after, the debtor performs has a right to withhold performance of the reciprocal obligation until the debtor has tendered performance or has performed”. This rule applies also where the other party has performed, but the performance is not in conformity with the contract. Further, the above-mentioned Article states that the performance which may be withheld is “the whole or part of the performance as may be reasonable in the circumstances”. Withholding performance is also allowed where the creditor “reasonably believes that there will be

non-performance by the debtor when the debtor's performance becomes due". Thus the rule is made applicable even in certain cases where the withholding party is to perform first.

Purposes of withholding performance. A distinction should be made between the rule on withholding performance and rules on the time for performance: in many cases it is agreed, or there is a presumption, that the parties are to perform simultaneously. In such cases, waiting for the other party's performance is not, strictly speaking, a remedy for non-performance. The party's performance is simply not due. The right to withhold performance – in the strict sense – has two main purposes, namely to protect the withholding party against granting credit and to give the other party an incentive to perform. The first of these purposes – protection against granting credit – has various aspects, depending on the type of contract and on the circumstances. If a lessee pays the rent before the goods are made available the lessee takes the risk of ending up with an unsecured claim in the lessor's insolvency proceedings. However, withholding performance with the aim of securing claims arising from the other party's non-performance can also be seen as protection against granting credit: a party having for example a right to claim damages for non-conforming performance should not be obliged to perform the full amount, and in so doing take the risk that the other party will not be able to pay the damages. This may also provide a guideline for the test of reasonableness in III.–3:401 (Right to withhold performance of reciprocal obligation): the party should normally be allowed to withhold so much as is needed to secure the party's remedies for non-performance.

Withholding performance distinguished from set-off. The provision in III.–3:401 (Right to withhold performance of reciprocal obligation) establishes no right to withhold performance after the other party has performed and therefore does not cover the situation where the aggrieved party wants to withhold performance in order to secure remedies for non-performance at a stage where the other party has performed, as for example where the performance was late and the aggrieved party may claim damages for consequential loss. This is a question of set-off, cf. Chapter 6 of Book III.

Withholding of performance and rent reduction. As will be discussed in Comment E, rent reduction is seen as a remedy for non-performance, not as a question of whether rent has been incurred or not. Hence, suspending rent payment because of non-performance is a question of withholding performance (or of set-off, as the case may be).

Withholding rent. Rent is in most cases payable at the end of certain intervals or at the end of the entire lease period, cf. IV.B.–5:102 (Time for payment). If the goods are not available for the lessee's use at the time for payment or the goods still do not conform to the contract, the lessee may withhold the whole payment or parts of it. Where the goods have been delayed, but have already been made available at the time established for payment, the lessee may – according to the rules in Book III, Chapter 6 – set off a claim for rent reduction or for damages against the lessor's claim for payment, cf. the two preceding paragraphs.

D. Right to terminate the contractual relationship for fundamental non-performance

Fundamental non-performance. The lessee may terminate the contractual relationship if the lessor's non-performance is fundamental, cf. III.–3:502 (Termination for fundamental non-performance) paragraph (1). A definition of fundamental non-performance is found in paragraph (2) of that Article, where the general criterion is the following (sub-paragraph (a)): the non-performance is fundamental if it “substantially deprives the creditor of what the creditor was entitled to expect under the contract ...”. According to sub-paragraph (b), intentional or reckless non-performance is fundamental if it gives “the creditor reason to believe that the debtor's future performance cannot be relied on”. In contracts for lease the prospects of future performance will typically be crucial in judging whether non-performance is fundamental under sub-paragraph (a), and whether or not non-performance is intentional or reckless under sub-paragraph (b).

Termination of a part or rent reduction? According to III.–3:506 (Scope of right when obligation is divisible), termination will in many cases affect only a part of the contractual relationship where the obligations under the contract “are to be performed in separate parts or are otherwise divisible”, if there is a “ground for termination ... of a part to which a counter-performance can be apportioned”. As applied to leases, this rule will often overlap with the rules on rent reduction. In cases where for a period of time (perhaps in the middle of the lease period) the goods have not been available for the lessee's use, or have been available but only with a serious lack of conformity, a rent reduction for the relevant period of time will usually be the simpler and more useful remedy (cf. the following paragraph). However, there may be cases where the lessee will prefer partial termination in order to put a decisive end to the lessee's own obligations.

Illustration 2

T runs activity holidays. She has concluded a contract with a firm, L, for the lease of 12 mountain bicycles, at so much per bicycle, for a week for the use of a party of clients. On delivery of the bicycles on the first morning one of them is found to be unfit for use. L has no more suitable bicycles in stock but says that it will obtain one within the next three days. This is no use to T who cannot have one client without a bicycle for that length of time. T would prefer to obtain a bicycle immediately from another firm and be free of any possible obligation to L in relation to the defective bicycle. T can terminate the lease in relation to the one defective bicycle.

E. Right to rent reduction

Rent reduction or rent not incurred? According to III.–3:601 (Right to reduce price), non-performance may give a creditor a right to a proportionate reduction in the price. This rule should obviously apply to contracts for lease in situations where the goods are made available for the lessee's use, but at a reduced value because of quality defects, third party rights etc. However, for periods where the goods are not available for the lessee's use at all, it may be questionable whether any rent has been incurred. Under this Part of Book IV, the rent reduction rule is meant to apply also to periods in which the

goods are not available. There are two reasons for this. First, this rule makes it unnecessary to make a sharp distinction between lack of conformity and non-availability. It may well be that the goods are made available to the lessee, but in a condition entirely unfit for use. In other situations the value of the goods may be substantially reduced for a period, even if the lessee can still make some use of the goods. The right to rent reduction is flexible enough to permit reduction to zero. Second, application of the rent reduction rule makes the system of remedies more consistent and simple, as there is no need to distinguish between “off-hire” periods and rent reduction. It must be added that other solutions may follow from the individual contract. A rule on rent reduction is included in IV.B.–4:104 (Rent reduction) to avoid misunderstandings on this and other points concerning the application of the general rules on price reduction. As discussed in Comment D second paragraph,, the creditor may have a choice between price reduction and partial termination.

Illustration 3

A leased computer breaks down one month after it has been made available to the lessee. The computer is brought to the lessor for repair, which takes one week. Rent is paid in advance every month. The lessee has a right to reduce the rent by one fourth of the monthly rent and can set off this amount against the rent for the following month.

Proportionate reduction. According to III.–3:601 (Right to reduce price) paragraph (1), the price reduction “is to be proportionate to the decrease in the value of what was received by virtue of the performance at the time it was made compared to the value of what would have been received by virtue of a conforming performance”. If the rent is agreed for certain periods, the agreed rent will normally indicate the proportionate reduction in value for periods where the goods have not been available. In other cases the reduction in value must be established using other criteria.

F. Right to damages and interest

General rules apply. Rules on damages for loss caused by non-performance and on interest for delay in payment of money are found in Book III, Chapter 3, Section 7. These rules also apply to lease contracts. Reference to interest is made in the present Article, even though the lessor’s obligations are normally non-monetary. For reasons that will be explained in the comments to IV.B.–4:105 (Substitute transaction), a small derogation has been found necessary concerning substitute transactions.

Lease period and liability. If the lessee terminates the contractual relationship for fundamental non-performance the general measure for calculation of loss is the following: the lessee must be put “as nearly as possible into the position in which the creditor [here: the lessee] would have been if the obligation had been duly performed”, III.–3:702 (General measure of damages). For lease contracts for an indefinite period, it should be noted that the lessor is not bound for a longer time than the required period for notice of termination. The lessee must accept that the lessor could have given notice of termination at the time the lessee terminated the contractual relationship.

G. Preconditions of remedies

Cure of non-performance. The lessor must in many cases be given a chance to cure non-performance, typically by remedying lack of conformity. The rules in Book III, Chapter 3, Section 2 apply without derogation.

Notification of remedies, knowledge of non-performance etc. IV.B.–4:106 (Notification of lack of conformity) deals with a further precondition for remedies, namely notification within a reasonable time, including a rule on the consequences of the lessor’s knowledge of the lack of conformity at the time of conclusion of the contract.

IV.B.–4:102: Rules on remedies mandatory in consumer contract

(1) In the case of a consumer contract for the lease of goods the parties may not, to the detriment of the consumer, exclude the application of the rules of this Chapter or derogate from or vary their effects.

(2) Notwithstanding paragraph (1), the parties may agree on a limitation of the lessor’s liability for loss related to the lessee’s trade, business or profession. Such a term may not, however, be invoked if it would be contrary to good faith and fair dealing to do so.

COMMENTS

A. Mandatory rules on remedies

Agreements excluding or restricting remedies. According to III.–3:105 (Term excluding or restricting remedies), the general rule is that remedies for non-performance may be excluded or restricted by a term in the contract, with the qualification, though, that such a term may not “be invoked if it would be contrary to good faith and fair dealing to do so”. For consumer contracts for lease (as defined in IV.B.–1:102) the main rule should be the opposite: agreements to the detriment of a consumer should not be allowed. Consumer protection is based mostly on the rules on remedies, while the parties are normally free to agree on performance: what is to be leased, at what price and for how long (but see IV.B.–3:106 (Limits on derogation from conformity rights in a consumer contract for lease)). An alternative could be to rely on general rules on unfair terms. This might, however, mean that the outcome would depend on the circumstances of the particular case. Making the rules on remedies mandatory offers a greater legal certainty in consumer contracts. The parties may, however, agree on derogations from the rules on remedies as long as the agreement is not to the detriment of the consumer. Further, an exception should be made for agreements limiting the lessor’s liability for losses related to the lessee’s trade, business or profession, cf. paragraph 2. Agreements settling claims based on non-performance are also allowed, as discussed in the following paragraph.

Settlement agreements. What may undermine consumer protection is agreements made *beforehand*, i.e. before the consumer lessee knows of non-performance. The typical imbalance between the business lessor and the consumer lessee with regard to bargaining

power and information could, if derogations were allowed, lead to the exclusion of or restrictions to remedies in situations where the lessee has no real choice or is blind to the consequences of the derogation. This holds true both for the initial contract and later amendments. However, where the lessee is aware of non-performance and invokes one or more remedies, the parties should be free to agree on a settlement. In this situation, the lessor is already bound by the contract, and it is normally much easier for the lessee to appreciate the consequences of a settlement than those resulting from a prior agreement. Admittedly, there may be cases where a consumer for various reasons accepts a settlement which a business party would have rejected, but this must be dealt with under the general rules on validity. It would be going too far to restrict all possibilities of settling an actual claim. It is not always easy to distinguish settlement agreements from agreements excluding or restricting remedies. In most cases an agreement concerning non-performance cannot be made prior to the lessee's notification of the non-performance, unless it is clear that the lessee, without having notified, nonetheless knows that there is non-performance. A settlement agreement can typically not comprise future non-performance (as where the lessee is offered compensation "once and for all").

Relevant remedies. It must be discussed with regard to each type of remedy whether or not a rule making the remedy mandatory is called for. As for the right to *enforce specific performance* of the relevant obligation, this remedy is already limited by general rules in order to avoid imposing an unreasonable burden on the debtor, cf. III.-3:302 (Non-monetary obligations) and Comment B to IV.B.-4:101 (Overview of remedies of lessee). Normally, a business lessor has no need to limit even more the lessee's right to enforcement of specific performance. On the other hand, it may be said that enforcement of specific performance is in many cases a rather cumbersome remedy to pursue, in particular for a consumer, and that a limitation to this remedy would often be of small practical importance. However, in the situations where the remedy is most needed, for example where repair of the goods by someone other than the lessor is hard to obtain, the consumer should be protected against derogations in the contract. The best practicable solution seems to be that the remedy generally cannot be excluded by contract in consumer leases. The *right to withhold performance of the reciprocal obligation* will protect the lessee from granting unsecured credit to the lessor and further give the lessor an incentive to perform. In particular the former of these effects is important to a consumer lessee. There is reason to believe that possible derogations from this right would lie precisely in those situations where the remedy was most needed. A consumer may not always appreciate beforehand the effects of a derogation clause. Both the right to *terminate the contractual relationship* and the *right to reduce the rent* are at the heart of the reciprocity of the contractual obligations: non-performance of the lessor's obligations has direct consequences regarding the lessee's obligations under the contract. Termination of the contractual relationship can sometimes be a drastic measure, entailing grave consequences for the lessor. It is, however, hard to see that there should be a legitimate need on the part of the lessor for derogation from a consumer lessee's right to terminate in the case of fundamental non-performance, or to limit the effects of such a termination. As for *rent reduction*, derogations are hardly justifiable in consumer leases; they would imply that the lessee was obliged to pay full rent for a counterperformance of reduced value. The remedies just discussed should be mandatory, in the sense that they

cannot be derogated from to the detriment of the consumer. The lessee's claim for damages, however, raises some particular problems, cf. next comment.

Limitation of liability for certain losses. The lessee is entitled to damages for loss caused by the lessor's non-performance, III.-3:701 (Right to damages), and the damages must as a rule "put the creditor as nearly as possible into the position in which the creditor would have been if the obligation had been duly performed" (III.-3:702 (General measure of damages)). The loss must, however, be foreseeable: "The debtor in an obligation which arises from a contract or other juridical act is liable only for loss which the debtor foresaw or could reasonably be expected to have foreseen at the time when the obligation was incurred as a likely result of the non-performance, unless the non-performance was intentional, reckless or grossly negligent", III.-3:703 (Foreseeability). Even with this foreseeability test the lessor may want to limit liability for losses related to the lessee's trade, business or profession. Such losses may occur for example where the breakdown of a leased car causes the lessee to return late from a holiday. The loss is foreseeable, but it is still different from the typical losses suffered in consumer relationships and more difficult to calculate from the lessor's point of view. Agreements limiting liability for these kinds of losses should be allowed. The term cannot be invoked, however, if it would be contrary to good faith and fair dealing to do so. The term can, for example, normally not be invoked if the non-performance was intentional, reckless or grossly negligent.

Non-business lessor. The definition in IV.B.-1:102 (Consumer contract for the lease of goods) does not include contracts between two non-businesses (consumer-to-consumer) or contracts between a non-business lessor and a business lessee (consumer-to-business). It should be considered whether or not there is a need for special rules on remedies in contracts where the lessor is a consumer (i.e. where the lessor is a natural person acting primarily for purposes which are not related to that person's trade, business or profession). There seems to be no reason to derogate from the general rules on remedies implying a temporary or permanent loss of income for the lessor, i.e. withholding of rent, reduction of rent and termination. These are remedies resulting from the reciprocity of the obligations and restricting the lessee's right to pursue them would mean an unacceptable imbalance in the contractual relationship. Normally, a non-business lessor will not have relied on the income from the lease to an extent that makes such remedies unreasonable. As for the lessee's right to enforce specific performance, including by remedying a lack of conformity, this may in some cases entail considerable costs for the lessor, in particular for a non-business lessor often dependent on professional assistance from third parties. However, specific performance cannot be enforced where performance would be unreasonably burdensome or expensive, and this flexible rule makes it possible to take the lessor's situation into consideration. Thus, no particular rule for non-business lessors seems to be necessary. Liability for damages may in some cases be burdensome for a non-business lessor, in particular where the lessee is a business which has suffered losses related to the trade, business or profession. In IV.A-4:203 (Limitation of liability for damages of non-business sellers), there is a rule limiting – with some exceptions – the liability of a non-business seller to the contract price. It does not, however, seem appropriate to include such a rule for lease contracts. Where the lease period can be

terminated by notice, the total rent amount may be very small compared with the loss normally to be expected as a result of non-performance, and the rule could put the other party in a most unsatisfactory position. The parties are free, within the general frame of good faith and fair dealing, to agree on limitations of liability, cf. III.–3:105 (Terms excluding or restricting remedies). Further, the prerequisite of foreseeability, III.–3:703 (Foreseeability) and the lessee’s duty to reduce the loss, III.–3:705 (Reduction of loss) will work in favour of the non-business lessor as much as the business lessor. In some cases, a non-business lessor may invoke the excuse of impediment, cf. III.–3:104 (Excuse due to an impediment), even if a business lessor would not be in a position to do so in a corresponding situation (e.g. where the non-business lessor could not reasonably have been expected to have taken the impediment into account or to have overcome its consequences). The conclusion is that there is not sufficient need to include special rules on remedies against non-business lessors.

B. Non-mandatory rules on performance

Quality, quantity and price. It follows from the principle of freedom of contract that the parties, consumers as well as business parties, are free to agree on what goods are to be leased, their quantity and quality and the rent to be paid. Rules concerning these issues (cf. Chapters 3 and 5) are default rules intended to supplement the individual agreement. This is also the case for consumer leases: the lessee may well agree to lease goods of substandard quality or to pay more than the market price. Consumer protection is concentrated on remedies, cf. Comment A, in addition to rules on pre-contractual information, the right to withdraw etc.

Descriptive terms restricting remedies. Sometimes the terms of a contract are formulated as general descriptions of the performance while the real effect is to restrict remedies. This may be the case if the lessee agrees to “accept” the goods as they are at the time when the contract is made or declares “knowledge” of the quality of the goods. Such terms may for example serve as a warning that the goods are not new, and that traces of earlier use of the goods must be expected. However, if the goods are in a condition worse than the lessee would reasonably expect under the circumstances, despite the above-mentioned contractual term, there is a lack of conformity and the ordinary rules on remedies apply to a consumer contract for lease (and often to other leases as well). Mandatory rules on remedies can of course not be circumvented just by the use of other words. This issue is dealt with in IV.B.–3:106 (Limits on derogation from conformity rights in a consumer contract for lease) (see Comments to that Article). As a guideline, specific descriptions and warnings may be accepted while broad reservations regarding quality and quantity may be without effect.

IV.B.–4:103: Lessee’s right to have lack of conformity remedied

(1) The lessee may have any lack of conformity of the goods remedied, and recover any expenses reasonably incurred, to the extent that the lessee is entitled to enforce specific performance according to III.–3:302 (Non-monetary obligations).

(2) Nothing in the preceding paragraph affects the lessor's right to cure the lack of conformity according to Book III, Chapter 3, Section 2.

COMMENTS

A. Right to have lack of conformity remedied

Need for rules on lessee's own remedying of lack of conformity. In Book III, Chapter 3, there are no rules explicitly dealing with the creditor's right to have a lack of conformity remedied and recover the costs from the debtor. In most cases this is a matter of damages: the cost of remedying the lack of conformity is part of the loss that the creditor can claim damages for, cf. III.–3:702 (General measure of damages). The situation may even be such that the debtor is not liable for the loss that can be *reduced* by such remedying, cf. III.–3:705 (Reduction of loss). In contracts for lease there is an additional problem: the goods do not belong to the lessee, and it must be decided to what extent the lessee may be permitted to have work done to the leased goods. For this reason a provision on the lessee's right to have the lack of conformity remedied is introduced in the present Article. According to the first paragraph, the lessee may have the lack of conformity of the goods remedied and may recover reasonable expenses incurred, to the extent that the lessee is entitled to specific performance. This rule limits the lessee's right to remedy the lack of conformity both with regard to the kind of work that may be done and with regard to the costs that may be recovered.

Work that may be done. The lessee may not claim specific performance – and therefore may not remedy a lack of conformity – where such performance would be unreasonably burdensome or expensive, cf. III.–3:302 (Non-monetary obligations) paragraph (3)(b). “Unreasonably burdensome” may cover situations where the lessor has good reason to object to work necessary to remedy the lack of conformity, cf. Illustration 1 to IV.B.–4:101 (Overview of remedies of lessee).

Unreasonable costs. The lessee is not entitled to enforcement of specific performance – or to have a lack of conformity remedied – if it would be unreasonably expensive, cf. III.–3:302 (Non-monetary obligations) paragraph (3)(b). This rule applies whether the remedying is to be done by the lessor, by the lessee or by a third party. Should the lessee be willing to bear some of the costs, and claim refund only of reasonable costs, the lessee may have the work done, if it would not be unreasonable for other reasons, cf. the preceding paragraph. The first paragraph of the present Article allows for recovery of expenses “reasonably incurred”. This rule overlaps with the rule on limitations to the right to specific performance where the work will lead to unreasonable expenses in any case. However, the rule also applies where the lessee has chosen an unnecessarily expensive means of remedying the lack of performance, even if the costs are not disproportionate *per se*.

Lessee's obligation of care. The lack of conformity may be remedied by the lessee or the lessee's employees or by a third party. The lessee must handle the goods with care, cf.

IV.B.–5:104 (Handling the goods in accordance with the contract). If the lessee plans to have work done on the goods by someone who lacks the necessary qualifications, the lessor may object, as this will normally be unreasonable from the point of view of the lessor. The lessor can also claim damages for loss caused by the lessee's carelessness in this respect.

Lessor's right to cure unaffected. The lessor normally has a right to cure if the lessee wants to exercise a remedy for non-performance, cf. Book III, Chapter 3, Section 2. In such cases, the lessor must be allowed the opportunity to remedy the lack of conformity before the lessee does so.

IV.B.–4:104: Rent reduction

(1) The lessee may reduce the rent for a period in which the value of the lessor's performance is decreased due to delay or lack of conformity, to the extent that the reduction in value is not caused by the lessee.

(2) The rent may be reduced even for periods in which the lessor retains the right to perform or cure according to III.–3:103 (Notice fixing additional time for performance), III.–3:202 (Cure by debtor: general rules) paragraph (2) and III.–3:204 (Consequences of allowing debtor opportunity to cure)).

(3) Notwithstanding the rule in paragraph (1), the lessee may lose the right to reduce the rent for a period according to IV.B.–4:106 (Notification of lack of conformity).

COMMENTS

A. Rent reduction

Clarification of the general rule. The first paragraph of the present article clarifies the general rule on price reduction (III.–3:601 (Right to reduce price)) for the purposes of lease contracts. Firstly, the lessee may reduce the rent as a consequence of delay or lack of conformity, i.e. for periods during which the goods are still not available and for periods during which non-conforming goods are accepted by the lessee, cf. Comments D and E to IV.B.–4:101 (Rent reduction). Secondly, it is made clear that rent may be reduced for the entire period during which the value of the lessor's performance is diminished. This means that the lessee may reduce the rent even for periods where the lessor has still not had a chance to cure a lack of conformity, for example by way of repairs. Whether or not it was possible for the lessor to cure is relevant to a claim in damages, but not to rent reduction. However, to the extent that the lessee caused the decrease in value, the lessee cannot reduce the rent. This rule, stated in III.–3:101 (Remedies available) paragraph (3), is included in the present provision, as the wording might otherwise be regarded as too wide.

Derogation from general rules. The second paragraph of the present article, in combination with the wording of the first paragraph, makes it clear that the lessee may

reduce the rent even if the lessee has given notice allowing the lessor an additional period for performance. Under the general rule in III.–3:103 (Notice fixing additional time for performance) paragraph (2), the creditor may withhold performance during the additional period “but may not resort to any other remedy”. This rule would lead to unfortunate results in lease contracts, where the lessee’s performance is normally directly related to a period of time. For this reason, the lessee may also reduce the rent during the period allowed for cure. According to the general rule found in III.–3:204 (Consequences of allowing debtor opportunity to cure), the creditor may withhold performance during this period “but may not resort to any other remedy”.

Illustration 1

The engine of a leased boat breaks down. The lessor wants to replace the engine, and this can be done in one week. The lessee did not intend to use the boat much during the relevant week anyhow and cannot resort to termination of the contractual relationship. As the boat cannot be used at all while the engine is being replaced, the lessee can claim a rent reduction equal to one week’s rent.

Late notification. The third paragraph of the present article refers to the notification rule in IV.B.–4:106 (Notification of lack of conformity), according to which the lessee, in case of late notification, may lose the right to rely on non-performance for a period corresponding to the unreasonable delay in notification.

IV.B.–4:105: Substitute transaction by lessee

Where the lessee has terminated the lease under Book III, Chapter 3, Section 5 (Termination) and has made a substitute transaction within a reasonable time and in a reasonable manner, the lessee may, where entitled to damages, recover the difference between the value of the terminated lease and the value of the substitute transaction, as well as any further loss.

COMMENTS

A. Calculation of loss

Price and value. A rule on calculation of loss caused by termination of a contractual relationship for fundamental non-performance of a debtor’s obligation is found in III.–3:706 (Substitute transaction). If the creditor makes a reasonable substitute transaction, the creditor may – in addition to further losses – “recover the difference between the contract price and the price of the substitute transaction”. This formula may lead to misunderstandings in lease contracts. Rent may be agreed as an amount per day, per month etc., while the lease period may be much longer or indefinite. A mere comparison of agreed rent for two contracts will not directly indicate the loss suffered by termination of the contract. What must be compared are the values of the two contracts, normally established by means of a cash flow analysis. This allows for comparison between

contracts for lease and contracts for sale as well, see the following paragraph. A parallel provision is found in IV.B.–6:105 (Substitute transaction by lessor) regarding non-performance of the lessee’s obligations.

Substitute transaction other than a lease. A substitute transaction resulting from termination for fundamental non-performance of the lessor’s obligations under a contract for lease is not always a new lease contract. In the circumstances it may be necessary, or at least more practical, to buy goods serving the same purposes as those for which the leased goods were intended. The value of the lease contract must be compared with the value of the sales contract (in practice a comparison of net present values of costs if the expected income is unchanged).

IV.B.–4:106: Notification of lack of conformity

(1) The lessee cannot resort to remedies for lack of conformity unless notification is given to the lessor. Where notification is not timely, the lack of conformity is disregarded for a period corresponding to the unreasonable delay. Notification is always considered timely where it is given within a reasonable time after the lessee has become, or could reasonably be expected to have become, aware of the lack of conformity.

(2) When the lease period has ended the rules in III.–3:107 (Failure to notify non-conformity) apply.

(3) The lessor is not entitled to rely on the provisions of paragraphs (1) and (2) if the lack of conformity relates to facts of which the lessor knew or could reasonably be expected to have known and which the lessor did not disclose to the lessee.

COMMENTS

A. Notification within a reasonable time

Purpose. The lessee must notify the lessor of a lack of conformity within a reasonable time. Notification may be necessary to give the lessor a chance to cure the lack of conformity, and in any case the lessor has a legitimate interest in knowing whether or not the lessee will make a claim based on non-performance. This is important in particular for reductions in rent. The lessor should have the opportunity to earn the full rent by remedying the lack of conformity. With regard to damages, the situation may be such that the lessor’s non-performance is excused for a period if the lessor could not have known of the lack of conformity, but even in this respect there is a need for a rule on notification to avoid doubt. The lessor should also be given a chance to cure or to take other measures before the lessee is allowed to terminate the contractual relationship for fundamental non-performance.

Reasonable time. Notification may always be given within a reasonable time after the lessee has become, or could reasonably be expected to have become, aware of the lack of conformity. What is a reasonable time will depend on the circumstances, for example the

kind of goods leased, the parties involved, the lease period, the actual phase of the contract, and the nature of the lack of conformity. A notification can be too late even if it is given immediately after the lessee has become aware of the lack of conformity if the lessee could reasonably have been expected to have become aware of it earlier. It has not been deemed necessary to include a provision concerning the lessee's examination of the goods. A duty to examine would only refer to the situation at the start of the lease period, but the notification rule also relates to a lack of conformity arising during the lease period. In any case, where the lack of conformity could have been discovered by normal examination, this should be taken into consideration when establishing what the lessee should reasonably have been aware of. When the lease period has come to an end, the general rule in III.-3:107 (Failure to notify non-conformity) applies, cf. paragraph (2) of the present Article. The difference between the two provisions lies in the cut-off effect, cf. Comment B4.

Informing of lack of conformity. The lessee must give sufficient information to enable the lessor to identify the lack of conformity. Without such information the notification cannot serve its purpose. Often it is sufficient to explain the incorrect functioning, as the lessee cannot be expected to know why the goods do not function properly.

B. Effect of late notification

Cut-off effect. The effect of late notification is that the lessee cannot resort to remedies – typically rent reduction – for the lack of conformity in question for a period corresponding to the unreasonable delay. The lessee may, however, still resort to remedies with regard to the period which follows and of course with regard to other occurrences of lack of conformity for which notification is given in time. It has been found too harsh to leave the lessee without *any* remedies for the lack of conformity, including subsequent periods, as the lack of conformity continues to be a non-performance of the lessor's obligations. Also it has been considered preferable not to cut off remedies for the entire period prior to notification; this would lead to a loss of remedies for a period longer than the actual delay. The question of remaining remedies for subsequent periods does not arise when the lease period has not come to an end, and in this situation the general rule in III.-3:107 (Failure to notify non-conformity) applies.

No absolute time limit. For some types of contracts there are absolute time limits for notification of a lack of conformity, implying a cut-off effect for remedies irrespective of whether the creditor in the relevant obligation had – or could have – discovered the lack of conformity. Thus, in a contract for sale between two businesses, there is an absolute limit of two years from – in practice – delivery in IV.A-4:302 (Notification of lack of conformity) paragraph (2). No such absolute limit is found in this Part of Book IV. In a contract for lease lack of conformity is an issue both at the start of the lease period and during the entire lease period. Each instance of lack of conformity must be notified within a reasonable time.

C. Notification of remedy

Specific performance and termination for non-performance. According to III.–3:302 (Non-monetary obligations) paragraph (4) and III.–3:508 (Loss of right to terminate), a party may lose the right to enforce specific performance or the right to terminate the contractual relationship if enforced performance is not sought or notice of termination not given within a reasonable time after the party has become, or could reasonably be expected to have become, aware of the non-performance. These rules apply in addition to the rule in paragraph (1) of the present Article. Specific performance, along with remedying of a lack of conformity, and termination for non-performance, are remedies which directly affect the lessor’s performance. They must therefore be claimed within a reasonable time. A “neutral” notification according to paragraph (1) will not give the lessor sufficient information in this respect. A claim for performance or a notice of termination may be given in the first notification of lack of conformity, but the situation may also be such that there is still time after the first notification to claim performance or to give notice of termination.

Other remedies. There are no separate rules on notification regarding withholding of rent, claims for rent reduction or damages if notification of lack of conformity is given according to paragraphs (1) and (2) of the present Article. The lessee may, however, lose such claims according to general rules on good faith and faire dealing and prescription.

D. Exception to cut-off effect

Knowledge and non-disclosure. Comment A1 describes the purposes of the notification rule: the lessor needs information concerning the facts discovered by the lessee and concerning the lessee’s assessment of the performance. If the facts to which the lack of conformity relates to are already known to the lessor, or the lessor can reasonably be expected to know the facts, notification is not necessary regarding these facts. The lessor still needs to know however whether or not the lessee wants to pursue remedies (it might also be that the lessee approves of the goods). This interest is protected by the notification requirement, but only in so far as the lessor has disclosed the relevant facts to the lessee. There is no good reason to protect the lessor through a notification rule if the lessor knew that the performance did not conform to the contract but failed to disclose this information to the lessee. A corresponding provision is found in III.–3:107 (Failure to notify non-conformity) paragraph (3).

IV.B.–4:107: Remedies channelled towards supplier of the goods

(1) This Article applies where:

- (a) the lessor, on the specifications of the lessee, acquires the goods from a supplier selected by the lessee;*
- (b) the lessee, in providing the specifications for the goods and selecting the supplier, does not rely primarily on the skill and judgement of the lessor;*
- (c) the lessee approves the terms of the supply contract;*

(d) the supplier's obligations under the supply contract are owed, by law or by contract, to the lessee as a party to the supply contract or as if the lessee were a party to that contract; and

(e) the supplier's obligations owed to the lessee cannot be varied without the consent of the lessee.

(2) The lessee cannot claim performance from the lessor, reduce the rent or claim damages or interest from the lessor, for late delivery or for lack of conformity, unless non-performance results from an act or omission of the lessor.

(3) The provision in paragraph (2) does not preclude:

(a) any right of the lessee to reject the goods, to terminate the lease under Book III, Chapter 3, Section 5 (Termination) or, prior to acceptance of the goods, to withhold rent to the extent that the lessee could have resorted to these remedies as a party to the supply contract; or

(b) any remedy of the lessee where a third party right or claim prevents, or is otherwise likely to interfere with, the lessee's continuous use of the goods in accordance with the contract.

(4) The lessee cannot terminate the lessee's contractual relationship with the supplier under the supply contract without the consent of the lessor.

COMMENTS

A. Overview

“Financial leasing” and remedies. This Article applies mainly to contracts that correspond to the contracts dealt with in the Unidroit Convention on International Financial Leasing (Ottawa 1988). In these transactions the lessor has the role of a financing party, and the parties regularly seek to channel some of the lessee's remedies towards the supplier of the goods, past the lessor. This is the same rule established by the Unidroit Convention. Other special rules concerning the contracts described in the Convention are found in IV.B.-2:103 (Tacit prolongation) paragraph (4), IV.B.-3:101 (Availability of the goods) paragraph (2), IV.B.-3:104 (Conformity of the goods during the lease period) paragraph (2), and IV.B.-5:104 (Handling the goods in conformity with the contract) paragraph (2). The criteria for applying special rules are not the same for every one of these provisions, as different aspects of the contracts justify different rules. It is not a requirement for the application of this Article that the entire cost be amortised by rent payments. Thus the Article also applies to certain leases with so-called residual value.

B. Scope of application

Prerequisites. The Article applies where certain prerequisites are met. These prerequisites depend partly on the factual situation in which the contract is concluded and partly on the terms of the individual contract. The prerequisites are cumulative; it is therefore not sufficient that only some of them are met.

3. Goods supplied for the particular lease. The Article applies only where the lessor has acquired the goods on the basis of specifications provided by the lessee, from a supplier selected by the lessee. For practical purposes this means that the goods are acquired solely for the lease contract in question. This reflects the role of the lessor in such contracts: the lessor is typically a financing institution without supplies of goods for lease purposes and without any interest in purchasing goods that are not already intended for a particular client. The goods are normally meant for a single lease contract and not for several subsequent contracts with different lessees.

Specification of goods. The goods must have been acquired on the basis of specifications provided by the lessee. This means that the goods are acquired for the purposes and needs of the lessee, and that the lessor cannot unilaterally specify the goods to be acquired and their qualities. This element in particular justifies the fact that liability for lack of conformity is channelled past the lessor. It is not necessary that the specifications be drawn up by the lessee exclusively. Nor is it necessary that the lessee has had the last word in all respects. The lessee may have consulted an independent expert, the supplier, and even the lessor, but the specifications must be drafted for the lessee and to satisfy the lessee's own purposes. The lessor is of course free to abstain from the transaction if the specifications drawn up by the lessee are thought to be inappropriate.

Selection of supplier. The supplier must be selected by the lessee. Once again, this is a result of the characteristic role of the lessor in these contracts. In ordinary contracts for lease the lessor will decide where to source goods for the lease business. It is not necessary that the lessee choose freely, independently of the lessor. The lessor will normally want to approve the supplier, as the supply contract is made between the lessor and the supplier. It is not unusual that the supplier co-operates with a financing institution that will offer contracts for lease to the supplier's customers. Thus it can be said that the supplier has selected the lessor. However, with regard to the *lease* contract, the supplier is still selected by the lessee. This, too, is part of the justification for channelling liability to the supplier, past the lessor.

Specification of goods and selection of supplier. The rules apply only where the lessee has not primarily relied on the lessor's skill and judgement in specifying the goods and selecting the supplier. This is another element of the justification for relieving the lessor of some of the normal liability under the lease contract. As already mentioned in the two preceding paragraphs, the lessor may want to approve the specification of the goods and the selection of the supplier, and the lessor may also give advice in this matter. It is only when the lessee has *primarily* relied on the lessor's skill and judgement that the contract for lease will fall outside the scope of the present Article. If that is the case, the lessor has an active role not typical of the transactions dealt with here, and there is a presumption that the general lease rules apply.

Other elements of the transaction. The lessor may have given advice concerning other elements of the transaction, besides the specification of goods and the selection of a

supplier, for example concerning the costs of the transaction, lease period and profile of rent payments, tax and accounting effects, etc. This is not incompatible with application of this Article.

Approval of the terms of the supply contract. The lessee must have approved the terms of the supply contract. This is essential, as the supply contract will to a great extent determine the lessee's rights in the case of non-performance. Normally, however, the parties to the supply contract will be only the lessor alone and the supplier and the terms will be agreed by these two parties. It is not a prerequisite that the lessee have any influence on the terms; approval is sufficient. There are no formal requirements concerning the lessee's approval of the terms of the supply contract and proof of approval may be provided by any means, (cf. II.-1:107 (Form)). In most cases the parties will prefer to have the lessee's approval in writing, cf. I.-1:105 (Meaning of "in writing" and similar expressions).

Supplier's obligations owed to lessee. The rules contained in the present Article apply only where the supplier's obligations under the supply contract are owed to the lessee as a party to the contract or as if the lessee were a party to the supply contract. This is why the lessor may be partly relieved of liability for non-performance. In the Unidroit Convention, the lessee's rights under the supply contract are a *result* of the application of the Convention (or rather the national law implementing the Convention). Here, another solution is chosen: the lessee's rights under the supply contract are a *prerequisite* for applying the rules of the present Article. The supplier's obligations may be owed to the lessee as a result of a rule of law (national law) or as a result of the contract itself, where a stipulation in favour of the lessee as a third party is included.

Rules of law. If a rule of law, applicable to the relationship between supplier and lessee, provides that the supplier's obligations under the supply contract are owed to the lessee as if the lessee were a party to the contract, then the prerequisite for application of the present Chapter is met. It has not been deemed necessary to examine national law to establish whether or not such rules exist (apart from rules implementing the Unidroit Convention). It should be mentioned that rules on "direct action" found in some jurisdictions are normally subject to certain limitations, so that the supplier's obligations are not owed to the lessee entirely as if the lessee were a party to the contract.

Contract with lessee. The lessee may be a party to the supply contract, together with the lessor, to the effect that the supplier's obligations are owed to the lessee. Whether or not this is the case must be established by ordinary interpretation of the contract.

Stipulation in favour of the lessee as a third party. The supplier and the lessor may stipulate in the supply contract that the supplier's obligations are owed to the lessee as if the lessee were party to the contract, cf. the general rules on stipulation in favour of a third party in Book II, Chapter 9, Section 3. If it is further agreed that the supplier's obligations cannot be varied without the consent of the lessee (cf. the following

paragraph), the rules of the present Article will apply (provided the other prerequisites are also met).

Supplier's obligations cannot be varied without lessee's consent. It is not sufficient that the supplier's obligations under the supply contract are owed to the lessee; it must also be ensured – whether via application of a rule of law or under the contract – that these obligations may not be varied without the lessee's consent. In particular, this qualification is important with regard to a stipulation in favour of the lessee as a third party in the contract between lessor and supplier, as the contracting parties may in many cases remove, revoke or modify the third party's right, cf. II.–9:303 (Rejection or revocation of benefit), unless otherwise agreed.

C. Effects

Channelling liability past the lessor. The effect of the present Article is such that liability for non-performance on the part of the lessor is, to a certain extent, channelled past the lessor. Some of the normal remedies cannot be pursued against the lessor, and in such instances the lessee is left with the sole option of pursuing the supplier. The remedies will mainly depend therefore on the supply contract, rather than the lease contract. The precise scope of the supplier's liability to the lessee is not expressed in the present article, such liability being a prerequisite for applying the Article at all.

Overview. In the case of late delivery, including non-delivery, and lack of conformity the lessee cannot claim performance from the lessor, reduce the rent, or claim damages. Such non-performance is normally caused by the supplier. The lessor must, however, accept rejection of the goods, termination of the contractual relationship under the lease contract, or withholding of rent prior to acceptance of the goods, as the case may be, but only to the extent that the lessee may resort to these remedies as a party to the supply contract. In such cases, the lessor will normally have a corresponding right to terminate the lessor's own contractual relationship with the supplier under the supply contract or to recover from the supplier loss caused by late payment. Where non-performance is the result of an act or omission of the lessor, remedies against the lessor will be available according to the general rules.

Purpose of the rules. The reasoning behind these rules is based on the special role of the lessor in the transaction, normally that of a financing institution. The supplier controls availability and conformity of the goods, and the lessor's main interest is to recover what is generally in real terms a credit granted to the lessee. If the ordinary lease rules were to apply, the lessor would be liable to the lessee and would then have to recover from the supplier any loss caused by the supplier. The effect of the rules contained in the present Article is such that the lessee must pay the rent to the lessor and may then recover any loss sustained from the supplier. The lessee will thus to a certain extent bear the risk of the supplier's insolvency and take the burden of litigation, something that can be justified by the lessee's having selected the supplier.

Specific performance. The lessee cannot enforce specific performance by the lessor, whether in the form of claiming the goods in cases of late delivery or in the form of remedying lack of conformity by substitution or repair. Normally the lessee can enforce specific performance by the supplier, based on the supply contract.

Reduction of rent. The lessee cannot reduce the rent for late delivery or lack of conformity (prior to acceptance of the goods rent may, however, be withheld). In ordinary leases, the lessee may reduce the rent to zero for periods where the goods have not been made available at all and reduce the rent proportionally where the goods do not conform to the contract. Under the contracts dealt with here, the lessee will have to pay the rent and then claim rent reduction or damages from the supplier.

Damages and interest. The lessee cannot claim damages (or interest, if relevant) from the lessor. Damages obtained from the supplier under the supply contract may, however, compensate the loss.

Termination of the contractual relationship with the lessor. The lessee may terminate the lease if such termination would be allowed under the supply contract. Termination may take place before or after acceptance of the goods. If the lease is terminated, the lessor will not receive future rent, while the lessee cannot claim the goods or must return the goods if they have already been accepted. The lessor may in turn terminate the lessor's contractual relationship with the supplier under the supply contract, and is thus relieved of the obligation to pay for the goods, or granted the right to claim for recovery of sums already paid, in addition to other losses incurred. Should the supplier be unable to pay, the goods may serve as security for the lessor.

Withholding of rent, rejection of goods. Prior to acceptance of the goods, the lessee may withhold rent because of late delivery or the tender of non-conforming goods, to the extent that the supply contract allows for payment to be withheld in such situations. The lessee may also reject non-conforming goods if this is allowed under the supply contract. After acceptance of the goods, however, rent may not be withheld because of lack of conformity of the goods.

Hidden lack of conformity. The effects of these rules can be illustrated by a case of a hidden lack of conformity. In the case of a lack of conformity of which the lessee could not have been expected to be aware on acceptance of the goods, rent may not be withheld. The reason given is that the lessor, typically a financing party, would be left with a claim against the supplier for rent unpaid by the lessee, but no way of securing this claim as long as the lessee is allowed to keep the goods under the lease contract. However, the lessee may terminate the lease, if termination is allowed under the supply contract. The lessor may then take back the goods and terminate the lessor's relationship with the supplier under the supply contract, the goods serving as security for claims against the supplier. The lessee may not reduce the rent because of a hidden lack of

conformity or claim damages from the lessor, for the same reasons. Such remedies would also leave the lessor with an unsecured claim against the supplier.

Non-performance resulting from lessor's act or omission. If late delivery or lack of conformity results from an act or omission of the lessor, the general rules on remedies for non-performance apply, and the lessee may resort to any remedy relevant, including rent reduction, withholding of rent, even after acceptance of the goods, and a claim against the lessor for damages.

Third parties' rights. The rules contained in the present Article do not relieve the lessor of liability for non-performance resulting from a right or a claim of a third party which is likely to prevent or otherwise interfere with the lessee's use of the goods in accordance with the contract. The general rules apply, irrespective of the non-performance being related to the supplier or the lessor: the lessor may have bought goods that did not belong to the supplier, or it may be that dispositions of the lessor or rights of the lessor's creditors interfere with the lessee's use.

Lessee's termination of the lessee's relationship with supplier under supply contract. The rules of the present Article apply only where the supply contract imposes obligations on the supplier with regard to the lessee (as a party to the supply contract or as if the lessee were a party to that contract). There is thus a legal relationship between the lessee and the supplier. This means that the lessee can also terminate this legal relationship where termination is foreseen by the contract or is permitted under the general rules on non-performance. A limitation is made in the fourth paragraph of the present Article: the lessee may not terminate the relationship with the supplier under the supply contract without the consent of the lessor. The lessor will typically want to have some say in situations where the lessee's obligation to pay rent is terminated and the goods are returned to the supplier. Termination may also lead to disputes concerning the lessor's rights under the supply contract. It is therefore appropriate that termination take place only with the lessor's consent. The lessee may in any case resort to the right to terminate the *lease* if the lessor's consent is for some reason denied.

CHAPTER 5: OBLIGATIONS OF THE LESSEE

IV.B.-5:101: Obligation to pay rent

(1) The lessee must pay the rent.

(2) Where the rent cannot be determined from the terms agreed by the parties, from any other applicable rule of law or from usages or practices, it is a monetary sum determined in accordance with II.-9:104 (Determination of price).

(3) The rent accrues from the start of the lease period.

COMMENTS

A. Reference to the contract and default rules

The contract. Normally, the parties have agreed on the rent to be paid. The rent may be agreed as an amount for the entire lease period. More often though the rent is agreed as an amount per interval of time (rent per hour, day, month, etc.). In some cases the amount to be paid is not spelt out in the contract, but can be determined via a reference to price lists etc. In particular for long term leases, there may be rent regulation clauses of various kinds, for example a clause allowing one or each of the parties a right to claim adjustments to rent based on an index.

Default rule. Occasionally, the rent cannot be determined from the contract, even if it is agreed that a rent is to be paid. In such cases the rent must be determined by the rules in II.-9:104 (Determination of price). If the rent cannot be determined from agreed terms, from any other applicable rule of law or from pertinent usages and practices, “the price payable is the price normally charged in comparable circumstances at the time of the conclusion of the contract or, if no such price is available, a reasonable price”. Often there will be no sharp distinction between the agreement and the pertinent usages and practices established by the parties, or between common usages and practices and the rent normally charged (“market price”). If the rent cannot be determined from such criteria, the lessee must pay a rent that is reasonable. According to the definition in Annex 1, what is “reasonable” is to “be objectively ascertained, having regard to the nature and purpose of what is being done, to the circumstances of the case and to any relevant usages and practices”. Hence there is a certain overlap between reasonableness and the guidance that can be garnered from usages and practices.

B. Rent from the start of the lease period

Accrual and payment. Where rent is agreed for certain intervals, the period during which the rent accrues must be established. This must be done irrespective of the time agreed for payment, which may be at certain intervals or may not.

Accrual from the start of the lease period. As discussed in Comment E to IV.B.-4:101 (Overview of remedies of lessee), rent in principle accrues even for parts of the lease period during which the goods have not been available for the lessee’s use. Unavailability must be dealt with as a question of rent reduction (or partial termination, which will lead to the same result). The consequence of this is that the rent accrues from the start of the lease period, not from the time when the goods are made available, even where performance is late. The lessee can in most cases claim reduction of the rent to zero for the period of delay. If the delay was caused by the lessee, however, there is no claim for rent reduction, cf. III.-3:101(Remedies available) paragraph (3).

IV.B.-5:102: Time for payment

Rent is payable:

- (a) at the end of each period for which the rent is agreed;*
- (b) if the rent is not agreed for certain periods, at the expiry of a definite lease period;*
- or*
- (c) if no definite lease period is agreed and the rent is not agreed for certain periods, at the end of reasonable intervals.*

COMMENTS

A. Time for payment

End of period for which rent is agreed. The parties normally agree on the time for payment. If the time of payment is not fixed by or determinable from the terms agreed by the parties, it is determined by the default rules found in the present Article. Where the rent is agreed for certain periods, for example a certain amount per month, the rent must be paid at the end of each month. The rent may be agreed for the entire definite lease period. In such cases the rent must be paid at the end of the lease period (it might be considered that this is also a period for which the rent is agreed, and that there is overlap between (a) and (b) in the first paragraph of the present Article). The default rule may admittedly lead to rather cumbersome results where the rent is agreed for very short periods (hours, days), but the parties are free to agree on another time for payment even after conclusion of the contract.

End of reasonable intervals. Where no definite lease period is agreed and the rent is not agreed for certain periods, the rent must be paid at the end of reasonable intervals. Guidelines for judging reasonableness are found in the definition of “reasonable” in Annex 1.

B. Place of payment

Lessor’s place of business. The place of payment may be fixed by or determinable from the terms agreed by the parties. If not, III.-2:101 (Place of performance) determines the place of payment. As a rule, money is to be paid at the creditor’s place of business as at the time of conclusion of the contract. If the creditor has more than one place of business, the place of payment is the place of business with the closest relationship to the obligation. Money must be paid at the creditor’s habitual residence if there is no business address. In practice, the lessor instructs the lessee to transfer money to a specified bank account in the country of the place of business or habitual residence, as the case may be.

IV.B.-5:103: Acceptance of goods

The lessee must:

- (a) take all steps reasonably to be expected in order to enable the lessor to perform the obligation to make the goods available at the start of the lease period; and*

(b) take control of the goods as required by the contract.

COMMENTS

A. Separate obligation to accept the goods

Obligation to co-operate and to take control of the goods. The lessee has a separate obligation to co-operate in order to enable the lessor to make the goods available (III.–1:104 (Co-operation)) and then to take control of the goods. This obligation is a parallel to the lessor’s obligation to accept the goods at the end of the lease period. Reference is made to IV.B.–3:107 (Obligations on return of the goods) and the comments to that Article.

B. Remedies

Protection of the goods etc. The lessor can resort to ordinary remedies for non-performance of the lessee’s obligations under the present Article. In addition there are rules in III.–2:111 (Property not accepted) on preservation of the goods etc., cf. Comment B to IV.B.–3:107 (Obligations on return of the goods).

IV.B.–5:104: Handling the goods in accordance with the contract

(1) The lessee must:

(a) observe the requirements and restrictions which follow from the terms agreed by the parties;

(b) handle the goods with the care which can reasonably be expected in the circumstances, taking into account the duration of the lease period, the purpose of the lease and the character of the goods; and

(c) take all measures which could ordinarily be expected to become necessary in order to preserve the normal standard and functioning of the goods, in so far as is reasonable, taking into account the duration of the lease period, the purpose of the lease and the character of the goods.

(2) Where the rent is calculated so as to take into account the amortisation of the cost of the goods by the lessee, the lessee must, during the lease period, keep the goods in the condition they were in at the start of the lease period, subject to any wear and tear which is normal for that kind of goods.

COMMENTS

Obligation to handle the goods in accordance with the contract. It is characteristic of contracts for lease that the lessee’s right – as opposed to the owner’s right – to benefit from the goods by use or by disposition is “positively” limited, i.e. the lessee may only use and dispose of the goods within the limits that follow from the contract. The lessee further has a general obligation to handle the goods with care. This obligation can be seen as including everything that the lessee is obliged to do, not to do, or to tolerate concerning the goods during the lease period. The present Article refers to the individual

agreement in paragraph (1)(a) and then states a general obligation of care in handling the goods in paragraph (1)(b). Obligations with regard to maintenance etc. are dealt with in paragraph (1)(c). A special rule on contracts where the rent is calculated so as to amortise the entire value of the goods is contained in paragraph (2).

B. Restrictions and requirements following from the contract

Express terms, purpose of use etc. The parties may have agreed on specific restrictions on and requirements for handling of the goods, including maintenance, safety measures, areas of use, cleaning etc. Even if there are few express terms, restrictions and requirements may follow more or less directly from the purpose of the contract.

Illustration 1

B is going to move from one apartment to another and leases a small van for that purpose. The van must not be used for transporting stones from B's quarry.

Handle the goods with care. The lessee has a general obligation to handle the goods with care. It is impossible to define in detail and exhaustively what this obligation implies. What is required will depend on the circumstances, including the length of the lease period, the purpose of the lease and the character of the goods. The lessee's acts and omissions must be judged against what a reasonable lessee would have done in the circumstances. Regard must also be had to obligations of repair and maintenance: if the consequences of the lessee's lack of care must be carried by the lessee and not by the lessor, this should influence the intensity of the lessee's obligation of care in handling the goods.

Maintenance etc. The obligations to repair and maintain the goods during the lease period are discussed in the Comments to IV.B.-3:104 (Conformity of the goods during the lease period). As mentioned there, the lessee's obligation to maintain the goods should be complementary to the lessor's obligations. The obligations on the lessee stated in paragraph (1)(c) and paragraph (2) of the present Article condition the lessor's obligation of maintenance, see also IV.B.-3:104 (Conformity of the goods during the lease period) paragraph (3). Any obligations placed on the lessee under paragraph (1)(c) are consequently excluded from the lessor's obligations under IV.B.-3:104 (Conformity of the goods during the lease period). Reference is therefore made to the comments to that Article.

Leases with full amortisation of the cost. The second paragraph of this Article includes special rules on contracts where the rent is calculated so as to take into account the full amortisation of the cost of the goods. The provision is formulated as a specified application of the first paragraph. In these cases the lessee must keep the goods in the condition they were in at the start of the lease period, subject to normal wear and tear. The reason is that these contracts for lease in real terms have the same function as contracts for sale. The rule covers both three-party transactions (often referred to as "financial leasing" etc.) and two-party long-term leases. Details are dealt with in Comment C to IV.B.-3:104 (Conformity of the goods during the lease period).

“Risk” and lessee’s obligation to return the goods. Loss of, or damage to, the goods can raise questions concerning the lessee’s obligation to return the goods. In such cases it is not a question of non-performance of the lessor’s obligations, but of non-performance of the lessee’s obligations. The rules on the lessee’s obligations to return the goods, including the rules on the condition of the returned goods, should ideally be a mere function of the rules concerning the lessee’s obligations of care, maintenance and repair. In other words, if the lessee has performed the obligations concerning care, maintenance and repair, the returned goods should generally conform to the rules on the condition of returned goods. The lessee is not, however, responsible for the consequences of loss or damage *not* caused by non-performance of the lessee’s obligations concerning care, maintenance and repairs (unless the contract states otherwise). In such cases then, the lessor must accept that the goods cannot be returned or that they can only be returned in damaged condition. There is no need here to formulate this as the “owner’s risk”, as it is sometimes done. On the other hand, where the lessee has a positive obligation to keep the goods in the condition they were in at the start of the lease period, the lessee must bear the consequences of accidental damage to the goods, either by repairing the goods or by paying damages, subject to relevant excuses based on impediment, cf. III.–3:104 (Excuse due to an impediment). Regarding contracts where the rent is calculated so as to amortise the entire cost of the goods, the expected value of the goods at the end of the lease period is usually low, cf. the exception for normal wear and tear in the second paragraph of the present Article. This will for practical purposes limit the lessee’s liability when the goods are lost by accident.

Agreements on “risk”. It is not unusual to find contract clauses to the effect that the lessee must bear the “risk” while in possession of the goods. This is typically the case in contracts for lease covering the entire economic lifespan of the goods, or contracts where the intention is to make the lessee owner of the goods at the end of the lease period. Similar clauses can, however, also be found in other contracts. The meaning of such clauses must be determined by interpretation in each case. Whether the clause deals with the lessor’s obligations, the lessee’s obligations or both can hardly be determined on a general basis. It is recommended that the parties agree on something more specific than the distribution of “risk”.

IV.B.–5:105: Intervention to avoid danger or damage to the goods

(1) The lessee must take such measures for the maintenance and repair of the goods as would ordinarily be carried out by the lessor, if the measures are necessary to avoid danger or damage to the goods, and it is impossible or impracticable for the lessor, but not for the lessee, to ensure these measures are taken.

(2) The lessee has a right against the lessor to indemnification or, as the case may be, reimbursement in respect of an obligation or expenditure (whether of money or other assets) in so far as reasonably incurred for the purposes of the measures.

COMMENTS

A. Measures ordinarily to be taken by the lessor

Purpose of the rule. The lessor often has an obligation to repair and maintain the goods during the lease period, see IV.B.–3:104 (Conformity of the goods during the lease period). Normally, the lessor will also have an interest in having the goods properly maintained and protected against damage even where the measures are not covered by a contractual obligation. Sometimes it is not possible or at least not practical for the lessor to take action, for example where the goods are located far from the lessor's business place or where repairs must be done immediately. This might be the case, for example, where repairs to the keel of a sailing boat are urgently required but the lessee has taken the boat to faraway waters, or where there is an urgent need to secure the counterweights of a building crane. According to the present Article, the lessee has an obligation to take measures to avoid danger or damage to the goods. To a certain extent one could rely on the rules on benevolent intervention in another's affairs (Book V), but the position here is that the lessee should have a contractual obligation to intervene.

Limitation of lessee's obligation. The obligation is limited in several respects: the intervention must be necessary to avoid danger or damage to the goods; it must be impossible or impractical for the lessor to take care of the matter; and it must not be impossible or impractical for the lessee to act.

Indemnification and reimbursement. The right to indemnification or reimbursement is a parallel to the corresponding right under Book V (Benevolent Intervention in Another's Affairs), Chapter 3. The rules in Book V may provide guidance in answering other questions concerning intervention and the consequences. The present Article should also be read along with the lessee's obligation to notify the lessor of any damage or danger to the goods, cf. IV.B.–5:107 (Obligation to inform).

Lessee's right to have a lack of conformity remedied. The lessee's obligation to intervene must not be confused with the lessee's *right* to have a lack of conformity remedied, see IV.B.–4:103 (Lessee's right to have lack of conformity remedied). The lessee has a right to have a lack of conformity remedied even where there is no danger to the goods. On the other hand, the lessee must respect the lessor's right to cure the lack of conformity.

IV.B.–5:106: Compensation for maintenance and improvements

(1) The lessee cannot claim compensation for maintenance of or improvements to the goods.

(2) Paragraph (1) does not exclude or restrict any claim the lessee may have for damages or any right or claim the lessee may have under IV.B.–4:103 (Lessee's right to have lack

of conformity remedied), IV.B.-5:105 (Intervention to avoid danger or damage to the goods) or Book VIII (Acquisition and Loss of Ownership in Movable).

COMMENTS

A. Improvements etc. to the goods by lessee

Introduction. Actions taken by the lessee, or on behalf of the lessee, may lead to improvements to the goods, or at least enhance the value of the goods compared with a situation in which no such action is taken. The present Article deals with the question of possible compensation for costs or for value added. As a rule, the lessee cannot claim such compensation, but there are several exceptions.

Performance of lessee's obligation of maintenance etc. Depending on the individual agreement and on IV.B.-5:104 (Handling the goods in accordance with the contract), the lessee may have an obligation to maintain the goods. In most cases maintenance will preserve the value of the goods and often the work will also lead to improvements, e.g. when worn parts are replaced with new parts. The lessee cannot claim compensation for such actions, unless otherwise agreed.

Improvements made with lessor's consent. The lessee may have the goods improved by having work done or by replacing or supplementing parts etc. with the consent of the lessor. The parties may agree on compensation to be paid (or deducted from the rent) at once or at the end of the lease period, perhaps including the calculated depreciation of the improvements. Where a claim for such compensation cannot be based on the contract, including the circumstances of the consent given by the lessor, the present Article states that the lessee is not entitled to compensation. This rule should encourage the parties to consider the question of compensation when the agreement on improvements is made. A default rule giving the lessee a claim for compensation would be more complicated, as several factors would have to be considered, such as the lessee's costs and the value and depreciation of the improvements. If the lessee terminates the contractual relationship for fundamental non-performance of the lessor's obligations, the fact that the benefit of any such improvements is withdrawn from the lessee may form part of the loss covered by a claim for damages. Should the contractual relationship be terminated by the lessor for fundamental non-performance of the lessee's obligations, the residual value of improvements may be taken into account as gains to be offset against the lessor's loss (*compensation lucre cum damno*).

Improvements made without lessor's consent. If the improvements are made without the lessor's consent, and they are not part of the lessee's obligations under the contract, there is even less reason to compensate the lessee. This should be the rule whether or not the lessee is allowed to make the relevant alterations to the goods without the prior consent of the lessor.

Lessee has remedied lack of conformity. The lessee may, under certain conditions, remedy a lack of conformity and recover the costs from the lessor, cf. IV.B.-4:103 (Lessee's right to have lack of conformity remedied). The present Article does not detract from the lessee's rights under this rule.

Lessee's intervention. Under Article IV.B.-5:105 (Intervention to avoid danger or damage to the goods), the lessee must in some cases perform maintenance and repairs to avoid danger or damage to the goods even if these measures should ordinarily be taken by the lessor. The present article does not affect the lessee's right to indemnification or reimbursement under that article.

Property law rules. There may be situations in which the lessee's obligations under the contract for lease concerning return of the goods are fulfilled even if improvements are "reversed", for example by replacing a new part with the old one. However, this may sometimes be contrary to the rules on accession, cf. Book VIII, Chapter 5 and the policies behind these rules. Under these rules, the result may be that the lessor may keep the improvements by compensating the lessee. The present Article does not derogate from such rules.

IV.B.-5:107: Obligation to inform

(1) The lessee must inform the lessor of any damage or danger to the goods, and of any right or claim of a third party, if these circumstances would normally give rise to a need for action on the part of the lessor.

(2) The lessee must inform the lessor under paragraph (1) within a reasonable time after the lessee first becomes aware of the circumstances and their character.

(3) The lessee is presumed to be aware of the circumstances and their character if the lessee could reasonably be expected to be so aware.

COMMENTS

A. Obligation to inform

General. The present Article concerns the obligation of the lessee to inform the lessor of damage and danger to the goods arising during the lease period, and likewise of third party rights, that become known to the lessee. The purpose of the rule is to make it possible for the lessor to defend the lessor's own interests. Non-performance of the lessee's obligation to inform may give rise to remedies, even if the lack of notification does not lead to actual loss. The lessor has a legitimate interest in relying on the lessee to give notification in these situations.

Illustration 1

The lessee notices that a leased car leaks brake fluid. This constitutes an immediate danger to the car (and to the driver as well as to third parties). The lessee is obliged to inform the lessor. The same will be the case if the lessee notices that the level of brake fluid has decreased considerably, without being able to spot any leak.

Illustration 2

The lessee has rented a boat for a trip up a river. Due to heavy rain the river becomes a torrent and the lessee does not dare to continue and needs help and perhaps the assistance of another boat in order to get back. In such a case the lessor should be informed.

Third party claims and rights. The obligation to inform also encompasses situations in which the lessee learns that a third party has a claim or right to the object. An example might be a case in which someone claims to be the rightful owner of the goods and wants to recover them.

Information within reasonable time. The lessee must provide such information a reasonable time after the lessee first becomes aware of the damage, claim etc., and that the circumstances require the lessor's attention (paragraph (2)). An obligation to do the impossible cannot be imposed. The lessee cannot therefore be obliged to notify something of which the lessee could reasonably be expected to be aware but was not in fact aware. However, the burden on the lessor of proving knowledge is eased by the rule in paragraph (3) that the lessee is presumed to be aware if the lessee could reasonably be expected to be aware.

Non-conformity not relevant. The lessee must inform the lessor according to this Article even if the danger or damage does not affect the lessee's use or in any way amount to non-performance of an obligation under the contract.

IV.B.-5:108: Repairs and inspections of the lessor

(1) The lessee, if given reasonable notice where possible, must tolerate the carrying out by the lessor of repair work and other work on the goods which is necessary in order to preserve the goods, remove defects and prevent danger. This obligation does not preclude the lessee from reducing the rent in accordance with IV.B.-4:104 (Rent reduction).

(2) The lessee must tolerate the carrying out of work on the goods which does not fall under paragraph (1), unless there is good reason to object.

(3) The lessee must tolerate inspection of the goods for the purposes indicated in paragraph (1). The lessee must also accept inspection of the goods by a prospective lessee during a reasonable period prior to expiry of the lease.

COMMENTS

A. Necessary repairs etc.

The lessee must tolerate repairs. The rule in paragraph (1) reflects the lessor's maintenance and repair obligations. The lessee must tolerate such work provided that, where possible, reasonable notice of it has been given. The lessee has, however, the right to rent reduction for periods during which the goods are not available for the lessee's use or where use of the goods has been affected by the work, see the discussion in Comment F to IV.B.-3:101 (Availability of the goods). Non-availability of the goods is a non-performance of the lessor's obligations even if the lessor has a right to perform the repairs etc. Correspondingly, the lessee has an obligation to tolerate the work in the sense that the lessee cannot prevent the work being done. The lessee's obligation to tolerate such work is, however, restricted to work and repairs which are necessary to preserve the goods, remove defects, and prevent danger. The lessee does not have to tolerate other work or repairs (unless there is no good reason to object, see Comment B). Otherwise it would be too easy for the lessor to interfere with the exclusive right of use of the lessee.

B. Other work

Obligation not to obstruct other work without good reason. The lessee's right under a contract for lease constitutes an exclusive right of use. The lessor in principle has no right to use the goods or take them away. This also applies to third parties. However, it would be unreasonable to completely bar the lessor from performing other work, e.g. updates to computers. The lessee therefore has an obligation to tolerate this kind of work where there is no good reason to protest. In deciding whether the lessee has good reason to object to such work, one must take into consideration both the consequences the work may have on the lessee and the lessor's interest in having the work done before the expiry of the lease.

C. Inspections

Inspections by lessor and by prospective lessees. Naturally, the lessee must tolerate inspection of the goods for the purposes indicated in paragraph (1). The lessee must also tolerate inspections by prospective lessees during the final period of the lease. In practice, this obligation will probably only arise in leases of durable and expensive goods (boats, cars, etc.).

IV.B.-5:109: Obligation to return the goods

At the end of the lease period the lessee must return the goods to the place where they were made available for the lessee.

COMMENTS

A. Obligation to return the goods

The obligation. The lessee has only a temporary right to use the goods, and at the end of the lease period the goods must be returned to the lessor. The parties may derogate from this rule, for example by giving the lessee a right to buy the goods at the end of the lease period or a right to prolong the lease period.

Time for return of the goods. The time for return of the goods is at the end of the lease period. The time at which the lease period ends follows from IV.B.–2:102 (End of lease period).

B. Place for return of goods

Place where the goods were made available. The goods must be returned to the place where they were made available for the lessee's use. As a rule, the goods are made available at the lessor's place of business, cf. IV.B.–3:101 (Availability of the goods) paragraph (1). The rule in the present Article is a deviation from III.–2:101 (Place of performance), which fixes the debtor's place of business as the place for performance of obligations other than paying money. In a contract for lease it will normally be more convenient to return the goods to the lessor's place of business. The lessor may have facilities for storing the goods; the goods will be repaired here before they are leased to another person; the goods will be made available here under a new lease contract; etc. If it has been agreed that the goods will be made available for the lessee's use at a place other than the lessor's place of business, this will also be the place to which the goods should be returned according to this rule. Even where the goods were made available at a place different to that originally agreed, this will be the place for return of the goods. It might be discussed whether the lessee is obliged to accept this: the place originally agreed upon is the place to which the lessee expects to return the goods. Nevertheless, if the lessee has accepted the goods at a different place, it should normally be possible to return the goods to the same place. In this way the rule is also simpler and less ambiguous.

CHAPTER 6: REMEDIES OF THE LESSOR

IV.B.–6:101: Overview of remedies of lessor

If the lessee fails to perform an obligation under the contract, the lessor may be entitled, according to Book III, Chapter 3 (Remedies for Non-performance) and the provisions of this Chapter:

- (a) to enforce performance of the obligation;*
- (b) to withhold performance of the reciprocal obligation;*
- (c) to terminate the lease;*
- (d) to damages and interest.*

COMMENTS

A. General

Scope of this Chapter. The provisions of the present Chapter apply where “the lessee fails to perform an obligation under the contract”. Thus the scope is limited to non-performance of the lessee’s obligations; cf. the parallel provisions in Chapter 4 concerning remedies of the lessee.

Reference to general rules. The lessor may be entitled, depending on the circumstances, to any or several of the listed remedies according to Book III, Chapter 3 and the provisions of the present Chapter. This formula implies that the general rules are partly supplemented, and partly derogated from, by the provisions of the chapter.

Listing of remedies. The list of remedies is exhaustive, but the remedies are described in a general way and more specific rules are found in Book III, Chapter 3 and the subsequent provisions of the present Chapter. The reference to “termination of the lease” in sub-paragraph (c) is to termination in whole or in part of the contractual relationship resulting from the contract for lease (cf. III.–3:501 (Scope and definition) paragraph (2)).

B. Right to enforce performance

Enforced specific performance of non-monetary obligations. Some of the lessee’s obligations are non-monetary, for example the obligation to maintain the goods and the obligation to return the goods at the end of the lease period. The main rule, following from III.–3:302 (Non-monetary obligations), is that the lessor is entitled to enforce specific performance of such obligations. Several exceptions are, however, mentioned in the Article referred to: specific performance cannot be enforced where performance would be unlawful or impossible; where performance would be unreasonably burdensome or expensive; or where performance would be of such a personal character that it would be unreasonable to enforce it.

Enforced specific performance of monetary obligations. The creditor is entitled to enforce performance of monetary obligations according to III.–3:301 (Monetary obligations). This general rule has, however, important exceptions in cases where the other party is unwilling to receive performance. The rule on specific performance is restated in IV.B.–6:103 (Right to enforce performance of monetary obligations) in terms specific to the continuous performance of a lease contract.

C. Withholding performance

Goods are not made available. It follows from III.–3:401 (Right to withhold performance of reciprocal obligation) that a creditor who is to perform simultaneously or after the other party may withhold performance until the other party has tendered performance or has performed. If it is clear that there will be non-performance by the other party, even a creditor who is to perform first may withhold performance. These

rules apply to contracts for lease as well as other contracts. The observations made in Comment C to IV.B.–4:101 (Overview of remedies of lessee), regarding the lessee’s right to withhold performance, are also relevant to the lessor’s right to withhold performance: withholding of performance serves two purposes, namely to protect the withholding party from granting credit and to give the other party an incentive to perform. If the lessee is to pay rent before or at the start of the lease period, the lessor may withhold the goods in the sense that they are not made available to the lessee. In some cases the lessee may have other obligations that are to be performed before the goods are made available, for instance to make specifications or to provide necessary certificates for use of the goods.

Goods have been made available. The lessor’s obligation to keep the goods available for the lessee’s use is a continuous obligation. However, the performance of this obligation cannot be withheld after the goods have been made available to the lessee. The contract for lease implies that the lessee is given physical control of the goods, and to take the goods back would be to reverse a part of the performance, not to withhold it. Whether or not a lessor who has for some reason regained physical control of the goods may keep the goods because of non-performance of the lessee’s obligations will depend on the rules in Book VIII (Acquisition and Loss of Ownership in Movables). The lessor is entitled to withhold performance of other obligations, for example the lessor’s obligation to repair the goods, as a remedy for the lessee’s non-performance.

D. Termination

Fundamental non-performance. The lessor is entitled to terminate the obligations of both parties under the contract if the lessee’s non-performance is fundamental, cf. the rules in Book III, Chapter 3, Section 5. Fundamental non-performance is defined in III.–3:502 (Termination for fundamental non-performance) paragraph (2) and may relate both to monetary obligations (typically late payment of rent) and non-monetary obligations (typically the obligation to handle the goods with care).

Effects of termination. Termination implies that the lessor no longer wants performance by the lessee and that the lessor is no longer obliged to perform the corresponding obligations. As the lessor’s obligation to ensure that the goods remain available for the lessee’s use is also terminated, the lessor is entitled to have the goods returned. This follows from IV.B.–5:109 (Obligation to return the goods).

E. Damages and interest

Damages if non-performance is not excused. The lessor is entitled to damages for loss caused by the lessee’s non-performance, unless the non-performance is excused, cf. III.–3:701 (Right to damages). Non-performance of the obligation to pay rent will in most cases not be excused, but exceptions may occur, e.g. payment delayed due to a bank strike. Regarding non-monetary obligations, such as the obligation to handle the goods with care or the obligation to return the goods at the end of the lease period, excuses may be more relevant in practice.

Measure of damages. Damages may be claimed for actual loss as well as for future loss, and for both economic and non-economic loss, cf. III.–3:701(Right to damages) paragraph (3). As a rule the creditor is entitled to a sum that “will put the creditor as nearly as possible into the position in which the creditor would have been if the obligation had been duly performed”, cf. III.–3:702 (General measure of damages). If the lease is terminated the lessor is normally entitled to the rent for the remaining lease period, or put more precisely: the rent for the remaining time of a fixed leased period or for the time until the lessee could have terminated the lease by giving notice in the case of an indefinite lease period. The lessor must reduce the loss by taking reasonable steps, cf. III.–3:705 (Reduction of loss), typically by entering into a new lease contract. Further, the lessor may suffer loss because the goods are damaged or reduced in value for other reasons as a result of non-performance of the lessee’s obligations to handle the goods with care or to maintain the goods.

Benefits to lessor. The termination may in some cases mean that the lessor is left with a benefit that must be taken into consideration when recoverable loss is calculated. As already mentioned, the lessor must take reasonable steps to reduce the loss, typically by leasing the goods to another lessee. If the lessor chooses to use the goods for the lessor’s own purposes instead of entering into a new lease, the value of this benefit should be seen as a reduction of the loss. Unless otherwise agreed, the lessee is not entitled to compensation for improvements made to the goods, cf. IV.B.–5:106 (Compensation for maintenance and improvements). If, however, the lease is terminated and the improvements make it possible to achieve a higher rent than would otherwise be the case, this will reduce the loss. Accordingly, the improvements should also be taken into account if the lessor chooses to utilise the goods for the lessor’s own purposes.

Option to buy the goods. Some contracts give the lessee an option to buy the goods at the end of the lease period or even earlier. If the rent is calculated so as to take into account the amortisation of the cost of the goods, the option to buy can often be exercised at a nominal price. Also where rent payments amortise less than a substantial part of the value, the rent already paid may influence the price at which the option can be exercised. If the option to buy is lost because the lease is terminated as a result of the lessee’s non-performance, the lessor may be left with a benefit that the lessor would not have possessed had the option been exercised. However, as long as there is no agreement that ownership will pass, it remains hypothetical to say that the lessee would have exercised the option if the lease had not been terminated. The result is that the lessee will only be compensated for the benefit obtained by the lessor in so far as the lessor disposes of the goods up until the end of the agreed lease period.

Illustration 1

The lessee has leased a machine for three years with an option to purchase at a nominal price on the expiry of the lease period. After two and a half years, the lessee cannot pay the rent any more, and the lessor terminates the lease. It turns out that the goods have a much higher value than the option price at the end of the original lease period. The lessor’s loss is reduced by the possibility of leasing or

using the goods for the remaining half-year, but not by the difference between the value of the goods and the option price.

Interest. The lessor is entitled to interest on any sum of money that is paid late, and the lessee cannot invoke excuses. The relevant interest rate is “the average commercial bank short-term lending rate to prime borrowers prevailing for the contractual currency of payment at the place where payment is due”, cf. III.–3:708 (Delay in payment in money). Interest is added to the capital every twelve months, cf. III.–3:709 (When interest to be added to capital). For loss not covered by the interest, the lessor is entitled to damages according to the general rules on damages, cf. III.–3:708 (Delay in payment of money) paragraph (2).

F. Non-mandatory rules

Non-mandatory rules except for consumer contracts for lease. The rules of the present Chapter may be derogated from by agreement, except in the case of consumer contracts for lease, where the rules cannot be derogated from to the detriment of the consumer, cf. IV.B.–6:102 (Consumer contract for the lease of goods). The parties may agree on prerequisites for remedies, e.g. on conditions for termination, and on the effects of the remedies. The parties may for example agree that a party who fails to perform an obligation is to pay a specified sum to the other party. Such an agreement is valid, although an excessive sum may in some instances be reduced, cf. III.–3:710 (Stipulated payment for non-performance).

IV.B.–6:102: Consumer contract for the lease of goods

In the case of a consumer contract for the lease of goods the parties may not, to the detriment of the consumer, exclude the application of the rules of this Chapter or derogate from or vary their effects.

COMMENTS

A. Mandatory rules on remedies

Agreements on remedies. The parties may, at the outset, derogate from the rules of the present Chapter by agreement, see Comment F to IV.B.–6:101 (Overview of remedies of lessor). An exception must be made, however, for consumer contracts for lease, i.e. those between a business and a non-business lessee, cf. the definition in IV.B.–1:102 (Consumer contract for the lease of goods). Derogations to the detriment of the consumer should not be allowed. As discussed in Comment A to IV.B.–4:102 (Rules on remedies mandatory in consumer contract) on the corresponding rule concerning the lessee’s remedies, agreements settling a dispute must be accepted. Further, it must be kept in mind that the parties are free to form the obligations of the contract; the rules in Chapters 3 and 5 are non-mandatory (but cf. IV.B.–3:106 (Limits on derogation from conformity rights in a consumer contract for lease)).

Standardised damages, fees etc. Remedies are now and then agreed on in the contract as standardised damages, for example a fixed sum of money per day for delayed return of the goods or fixed “prices” for damaged parts of the goods. Other clauses may have the same effect: a “cancellation fee” may for example be compared to damages for fundamental non-performance. In such cases, the agreed remedy amounts to a derogation to the detriment of the consumer to the extent that the effect of the agreed clause in the particular case is less favourable to the consumer than would have been the effect of the remedies described in this Part of Book IV. It is not considered necessary to add a rule allowing for agreed remedies that are *typically* equal to or more favourable to the consumer than the rules contained in this Part of Book IV, even if the remedy is less favourable in the particular case.

Other remedies. The rules on the lessor’s right to *enforce specific performance* of the lessee’s obligations are flexible. For non-monetary obligations the rules are found in III.–3:302 (Non-monetary obligations). These rules exclude for example enforcement of specific performance where performance would be impossible or unreasonably burdensome. It has not been found appropriate to allow agreements derogating from such limitations of the lessor’s right. As for monetary obligations, there are rules specifically designed for lease contracts in IV.B.–6:103 (Right to enforce performance of monetary obligations). These rules are flexible, referring to a great extent to reasonableness, and there should be no legitimate need to derogate from the rules to the detriment of a consumer. Agreements extending the lessor’s right to *terminate* the contractual relationship, e.g. contract terms to the effect that any delay in payment or any use which does not accord with the contract is regarded as fundamental non-performance, can have unexpected and unreasonable effects, and there is hardly a strong need to apply such clauses in consumer contracts for lease.

IV.B.–6:103: Right to enforce performance of monetary obligations

(1) The lessor is entitled to recover payment of rent and other sums due.

(2) Where the lessor has not yet made the goods available to the lessee and it is clear that the lessee will be unwilling to take control of the goods, the lessor may nonetheless proceed with performance and may recover payment unless:

(a) the lessor could have made a reasonable substitute transaction without significant effort or expense; or

(b) performance would be unreasonable in the circumstances.

(3) Where the lessee has taken control of the goods, the lessor may recover payment of any sums due under the contract. This includes future rent, unless the lessee wishes to return the goods and it would be reasonable for the lessor to accept their return.

COMMENTS

A. General

Relationship with III.–3:301. The present Article is an adaptation of III.–3:301 (Monetary obligations) for the purposes of lease contracts. Performance of obligations to pay sums due can as a rule be enforced. However, where the other party does not want performance, or further performance, the situation may change and the obligation to pay sums due may, under certain conditions, be replaced by an obligation to pay damages.

B. Goods have not yet been made available

Enforced performance. Where the lessor has not yet made the goods available for the lessee's use and it is clear that the lessee will be unwilling to take control of the goods, the lessor may proceed with performance and recover sums due. Enforced performance of the lessee's obligation to accept the goods is in principle possible, but is rather impractical in most cases. The lessor may also handle the goods according to the rules in III.–2:111 (Property not accepted). In both cases the lessor may enforce payment of rent that is due and continue to do so throughout the lease period. There are, however, important exceptions to these rules, cf. the subsequent Comments.

Substitute transaction. If the lessee is unwilling to receive performance, the lessor may not proceed to tender performance in cases where a substitute transaction may be made without significant effort or expense. A substitute transaction will typically be a new lease contract. The lessor is entitled to have reasonable expenses covered, cf. Comment D7, but may fear that the lessee will not be able to pay. The lessor is therefore not obliged to make a substitute transaction if the expenses are significant.

Performance would be unreasonable. The lessor may not proceed to tender performance and enforce payment of sums due if this would be unreasonable under the circumstances. It may be the case that performance will incur unnecessary costs where the lessee can no longer make use of the goods. The lessor should for example not be allowed to enter into a contract for the supply of goods with a view to tendering performance if it is clear that the lessee is unwilling to receive performance.

C. Lessee has accepted the goods

Enforced performance. Where the lessee has taken control of the goods, the situation is different. The lessor may enforce payment of the rent that is due, at intervals throughout the lease period as the case may be, cf. the second paragraph of the present Article. However, even in this situation an exception should be made, see the following paragraph

Reasonable to take the goods back. If the lessee wishes to return the goods and it is reasonable for the lessor to accept return of the goods, the obligation to pay rent for the future period should be replaced by an obligation to pay damages. What is reasonable will depend on the situation of the parties, the kind of goods leased, the proportion of the agreed lease period remaining, etc. For a business lessor there are in many cases few

problems with accepting return of the goods, and the goods can in many cases be leased to new customers. In other situations, the lessor may have entered into the contract for lease so as to dispose of the goods for a certain period, and accepting return of the goods in such cases may cause practical problems and expenses. It may also be unreasonable to accept return of the goods even if the costs can be recovered from the lessee.

Illustration 1

Lessee X has leased a horse for a four-week holiday. After one week X falls ill and cannot use the horse or look after it. Lessor Y, whose business is to lease horses, must agree to take the horse back and to claim damages instead of the weekly rent.

Illustration 2

Lessor X, who lives in Piraeus, is stationed for one year in the organisation's branch office in Norway. X owns a cabin cruiser and leases the boat to Y for one year before leaving for Norway. After a couple of months Y is tired of being seasick and wants to return the boat. X no longer has a place for the boat and at this time of year it is difficult to find a new lessee. X may still enforce payment each month under the contract.

D. Effects

Damages covering lessor's loss. The lessor can claim damages if performance of the obligation cannot be enforced according the rules of the present Article, cf. III.–3:303 (Damages not precluded). The damages “will put the creditor as nearly as possible into the position in which the creditor would have been if the obligation had been duly performed”, in terms of losses suffered and gains not obtained, cf. III.–3:702 (General measure of damages). In these situations the general rule on reduction of loss applies, cf. III.–3:705 (Reduction of loss). To what extent a substitute transaction will reduce the loss depends on the circumstances. If the lessor can supply goods to any new customer, the lessor may recover loss of gains, even if the goods are leased to a new customer for the same rent. The idea behind allowing the lessee the right to refuse performance is partly that the lessor may save costs by not proceeding with the performance, and partly that payment may be settled at once as damages in lieu of future performance.

IV.B.–6:104: Substitute transaction by lessor

Where the lessor has terminated the lease under Book III, Chapter 3, Section 5 (Termination) and has made a substitute transaction within a reasonable time and in a reasonable manner, the lessor may, where entitled to damages, recover the difference between the value of the terminated lease and the value of the substitute transaction, as well as any further loss.

COMMENTS

A. Calculation of loss

Price and value. Calculation of loss in the event of termination for non-performance of a debtor's contractual obligations followed by a substitute transaction is covered in III.–3:706 (Substitute transaction). If the creditor makes a reasonable substitute transaction, the creditor may – in addition to further losses – “recover the difference between the contract price and the price of the substitute transaction”. This formula may lead to misunderstandings in lease contracts. Rent may be agreed as an amount per day, per month etc., while the lease period may be much longer or indefinite. A mere comparison of the level of agreed rent for two contracts will not directly indicate the loss suffered. What must be compared are the values of the contracts, normally established by means of a cash flow analysis. A substitute transaction is typically a new lease, but it may also be a sale of the goods. A parallel provision may be found in IV.B.–4:105 (Substitute transaction by lessee) regarding non-performance of the lessor's obligations.

IV.B.–6:105: Reduction of liability in consumer contract for the lease of goods

(1) In the case of a consumer contract for the lease of goods, the lessor's claim for damages may be reduced to the extent that the loss is mitigated by insurance covering the goods, or to the extent that loss would have been mitigated by insurance, in circumstances where it is reasonable to expect the lessor to take out such insurance.

(2) The rule in paragraph (1) applies in addition to the rules in Book III, Chapter 3, Section 7.

COMMENTS

A. Insurance and leases

No obligation to take out insurance covering contractual liability. No obligation to insure the goods is included in this Part of Book IV, whether on the side of the lessor or the lessee. Such obligations are often found in contract terms. Normally, a party to a contract will prefer to take out insurance covering the party's liability against the other party, e.g. liability under the contract for damage to or loss of the goods. (Sometimes a party will want insurance covering liability against third parties as well, e.g. liability for damage caused by the goods, liability for pollution etc.) It has not been deemed necessary to include an obligation to provide insurance of this kind. Further, it may be in the interests of one party to the contract that the other party has insurance covering that other party's liability under the contract. The reason for this is typically a fear that the liable party will be unable to pay damages. For business-to-business contracts, as well as for consumer-to-consumer contracts, the evaluation of the other party's ability to perform the obligations under the contract and meet claims arising from non-performance is one element in the complex decision to enter into a contract with that person. For business-to-consumer contracts a mandatory rule on insurance on the side of the business could be

discussed. This is, however, a general issue which concerns several contract types, not contracts for lease in particular, and such a rule is not included in this Part of Book IV.

No obligation to insure the goods. It is a characteristic element of the contract for lease that the lessee has control over and care of goods belonging to another person. Non-performance of the lessee's obligations may lead to liability for loss resulting from damage to or destruction of the goods. In many cases this loss – and the corresponding liability – is mitigated by ordinary insurance covering physical damage to the goods. It would hardly be possible to establish as a general rule that normal insurance should always be provided by the owner or always by the user. The cost – and even the availability – of insurance may vary according to the character of the goods, the length of the lease period, the planned use, the professionalism of the parties etc. As a rule then, it should be left to the parties to agree on the question of insuring the goods.

B. Consumer contracts for lease

Lessee's reasonable expectations. It seems impossible even for consumer contracts for lease to say that insurance should be provided by one of the parties in all cases. Consumer protection is, however, required to the extent that a lack of insurance coverage should not come as a surprise to the consumer. In situations where the consumer had reason to believe that the goods were insured by the lessor, and therefore did not take out insurance, the lessee's liability for loss or destruction of the goods should be reduced correspondingly. It may be that this result can be based on general rules on relevant loss and reduction of loss, but it seems appropriate to express it explicitly for consumer contracts for lease, where the question is most likely to arise in practice.

Existing insurance or expected insurance. Reduction of the lessee's liability should be available in two different situations. If the loss is in fact covered, partially or totally, by existing insurance, this may lead to reduced liability whether the existence of insurance coverage was reasonably to be expected or not. If the loss is *not* covered by insurance, liability may be reduced to the extent that the loss would have been mitigated had the lessor taken out insurance where such an action could reasonably have been expected. It must be determined from the circumstances whether the lessor could reasonably have been expected to provide insurance and, if so, in what form. The answer is obvious if the lessor is obliged by the contract to insure the goods. The lessor may also be expected to take out insurance where this is mandated by law. In other situations, regard must be had to insurance coverage that is commonly provided. The character of the goods and the length of the lease period may also be relevant.

Illustration 1

Consumer A leases a rather new car for the weekend from B, a business. The lessee drives too fast and loses control of the vehicle, which is severely damaged when it hits a road fence. Since it is usual to insure new cars against such loss, and the lessee was offered no short-term insurance when entering into the contract, the lessee's liability may be reduced by an amount corresponding to normal insurance coverage even if the car was not insured.

Coverage of insurance. Under the default rules of this Part of Book IV, the lessee is not liable for destruction or loss of the goods by fortuitous events: repair in such cases will normally go beyond the lessee's obligations under IV.B.–5:104 (Handling the goods in accordance with the contract), and the lessee is not obliged to return the goods in a condition better than that which follows from the obligation to maintain etc. The parties may, however, have agreed to impose more extensive obligations of maintenance and repair on the lessee. Further, the goods may be damaged as a result of non-performance of the lessee's obligation to handle the goods in accordance with the contract. It must also be determined from the circumstances to what extent it may be expected that insurance provided by the lessor will cover loss caused by the carelessness or negligence of the lessee.

C. Contracts for lease other than consumer contracts

General rules apply. The rule in paragraph (1) of the present provision applies in addition to the general rules in Book III, Chapter 3, Section 7 on damages, see paragraph (2) of the present provision. Situations may vary to a considerable degree, and it is not advisable to try to establish one rule for all cases concerning the effects or availability of insurance. Neither should the rule in paragraph (1) give rise to conclusions *a contrario*.

CHAPTER 7: NEW PARTIES AND SUBLEASE

IV.B.–7:101: Change in ownership and substitution of lessor

(1) Where ownership passes from the lessor to a new owner, the new owner of the goods is substituted as a party to the lease if the lessee has possession of the goods at the time ownership passes. The former owner remains subsidiarily liable for the non-performance of the obligations under the contract for lease as a personal security provider.

(2) A reversal of the passing of ownership puts the parties back in their original positions except as regards performance already rendered at the time of reversal.

(3) The rules in the preceding paragraphs apply accordingly where the lessor has acted as holder of a right other than ownership.

COMMENTS

Contracts for lease and change in ownership. Generally, a party to a contract may assign the right to performance under the contract (III.–5:105 (Assignability: general rule)), but the party will not be discharged of contractual obligations without the other party's assent (III.–5:301 (Transfer of a contractual position)). For lease contracts, a change in ownership of the leased goods raises some special questions. The lessor's position as owner of the goods (or holder of a comparable right) and as a party to the contractual relationship arising from the contract for lease are closely connected. In order

to perform the obligations under the contract the lessor must be able to make the goods available for the lessee's use and in most cases must also be able to carry out work on the goods in the form of maintenance and repairs. This normally presupposes that the lessor is the owner of the goods. Rules are needed concerning the consequences of a change of ownership regarding both the contractual relationship between the lessee and the original lessor and the relationship between the lessee and the new owner.

Contractual rights and protection of possession. The rule under this Article is that a new owner is substituted as a party to the contractual relationship arising from the lease contract. Even without this rule the lessee's possession of the goods may be protected to a certain extent under the rules on transfer of ownership, see Book VIII. To the extent that the lessee's possession is protected against a new owner this can be regarded as a "negative" obligation on the side of a new owner, an obligation to tolerate the lessee's use; while a substitution as a party to the contractual relationship implies that the new owner has "positive" obligations under the contract.

B. Models and policy issues

Lessor's right to dispose of the goods. It follows indirectly from the present Article that the lessor is allowed to dispose of the goods, by transferring ownership or otherwise. Such a change in ownership is not regarded by itself as a non-performance of the lessor's obligations, and the lessee cannot object to the transfer of ownership or stop it by claiming specific performance. This is also the situation for a change in ownership resulting from a forced sale or from actions by the lessor's general creditors. If, however, the change in ownership is likely to interfere with the lessee's use of the goods in accordance with the contract, this amounts to non-performance of an obligation under the contract, cf. IV.B.-3:101 (Availability of the goods) paragraph (3). Given that the new owner is normally substituted as a party to the contractual relationship and the former lessor remains liable for the performance of the obligations under the contract, a change of ownership will in most cases not interfere with the lessee's use. The situation may be different if the goods are sold after the conclusion of the contract but prior to the lessee's taking possession of the goods, or where rules on registration of rights result in a change of ownership without a duty on the new owner to respect the lease contract.

Enforceability against new owner. As for the relationship between the lessee and a new owner of the goods, there are two possible main models: there may be no relationship at all, or the lessee's right may have some protection in relation to other interests in the goods, including the interests of a new owner. Both models are found in national law. As long as the rules are transparent and relatively simple, prospective lessees or buyers of goods as well as security right holders and the lessor's general creditors can adjust their behaviour to the consequences of the rules. Arguments pointing to one model as the most fair or most economically efficient are hardly sustainable. The model chosen here, protecting a lessee who has taken possession of the goods, is likely to create fewer situations of non-performance and conflict than a model where the lessee has no protection against third parties at all. A change in ownership will not automatically lead to non-performance of the obligations under the lease contract, and a

prospective buyer or lender of money is warned by the fact that the owner of the goods is not in direct possession. The same kind of reasoning justifies the rule that a new owner is substituted as a party to the contractual relationship under the lease contract. If a new owner were only to have the passive duty of respecting the lessee's possession and use of the goods the rule could still lead to non-performance of the obligations under the contract for lease in many cases. Another reason for choosing this model is that some contracts for lease have more or less the same function as a contract for sale. A contract for lease may be chosen primarily to establish a security right in the goods, in particular where the contract confers on the lessee full use of the goods for their entire economic lifespan. In such cases the protection of the lessee should not differ too much from the protection afforded a buyer. If the lessee is to be protected in some contracts for lease of this type, the simplest solution is to apply the same rule to all leases. Otherwise it can be difficult to find exact criteria for differentiating between contracts.

New owner in good faith. A buyer of the goods with knowledge of the lease has normally accepted the substitution as a party to the contractual relationship with the lessee, and the price agreed is normally influenced by this knowledge. As the rule in the present Article applies only when the lessee has possession of the goods, the buyer in most cases knows or ought to know of the lease. The owner's lack of direct control of the goods should alert the buyer to the fact that other interests in the goods may exist, and the buyer can make further investigations. If the buyer does not know of the lease despite the fact that the lessee has possession of the goods, the unexpected existence of the contract for lease will often amount to non-performance of an obligation under the sales contract, cf. IV.A-2:305 (Third party rights or claims in general). The lessee's right is still protected, but the lessee must accept a reversal of the substitution of the buyer as a party to the contractual relationship, (see below). The individual contract for lease is decisive as to the terms regulating the rights and obligations between the new owner and the lessee. There may be cases where the terms of the contract are less favourable to the lessor than the buyer expected, even if it was known that a lease existed. It has not been found necessary to introduce an exception to the lessee's protection for these situations. Depending on the sales contract, the buyer is entitled to remedies against the seller, including termination of the contractual relationship and a retransfer of the goods to the seller, entailing a reversal of the change in ownership. A lessee lacking possession of the goods is not protected, irrespective of the buyer's knowledge. In this situation, the sale of the goods amounts to non-performance of an obligation under the lease contract, unless the buyer voluntarily takes on the obligations of lessor, perhaps as a result of an agreement between buyer and seller. A possible claim by the lessee against a buyer in bad faith is regulated by the rules in Book VI.

Protection against the lessor's general creditors. The rule in the present Article also applies where ownership is transferred to a new owner as a result of the lessor's general creditors satisfying their claims, through bankruptcy proceedings or individually. Protection against the lessor's general creditors can be justified in a situation where the lessee has possession of the goods. Rules of national bankruptcy law have priority over the present rules, however, and may lead to other results. In particular this is the case when it comes to rules on avoidance in bankruptcy.

C. The lessee has possession of the goods

New owner as lessor. If the lessee has possession of the goods at the time ownership passes the new owner is substituted as a party to the relationship under the lease contract, see the first sentence of the first paragraph of the present Article. This means that the lessee has rights and remedies against the new owner to the same extent as against the former owner, including enforcement of specific performance. The new owner, as a result of the substitution as party to the contractual relationship, has the rights under the contract for lease and can collect the rent. It must be decided according to the rules in Book VIII (Acquisition and Loss of Ownership in Movables) at what time ownership passes. The rules in that Book also define the prerequisites of the lessee's possession. The present Article applies where the new owner's right is derived from the former owner's right ("ownership passes from the lessor to a new owner") and thus not where the new owner has acquired rights in good faith under a transaction with a possessor not being the owner.

Illustration 1

X leases to Y five containers for industrial waste for a period of one year and the containers are brought to Y's premises at the start of the lease period and remain there. After six months, X sells the containers to Z without informing Z of the lease contract. Z is substituted as a party to the contractual relationship under the contract for lease and must tolerate that Y uses the containers for the rest of the lease period. Z must also repair one of the containers, which is damaged after eight months, as this falls under the lessor's obligations under the lease contract. On the other hand, Z can claim payment of rent directly from Y.

Former owner's liability. The former owner remains subsidiarily liable for non-performance of the obligations under the contract for lease as a personal security provider, cf. the second sentence of the first paragraph of the present Article. The former owner may be discharged only with the lessee's assent, cf. III.-5:301(Transfer of contractual position). Several of the lessor's obligations under a contract for lease cannot be performed by a person not being the owner of the goods or not having at least the owner's consent. Under these circumstances, the best practicable solution is to make the former owner subsidiarily liable as a personal security provider. For the purposes of Book IV.G.(Personal Security), the former owner becomes a provider of a dependent personal security, i.e. the former owner's obligation secures the new owner's obligations owed to the lessee. Before demanding performance from the former owner, the lessee must have made appropriate attempts to obtain performance from the new owner, IV.G.-2:106(Subsidiary liability of security provider) paragraph (2). In practice, the only performance possible for the former owner is payment of money, either as performance of a claim for money or as damages for non-performance of a non-monetary claim.

Illustration 2

The facts are the same as in Illustration 1. Due to Z's weak financial situation, the damaged container is not repaired, and Y has to lease an extra container

elsewhere. Y's claim for damages from Z receives no answer. Y can claim damages from X.

Reversal of the passing of ownership. The passing of ownership may be reversed, and then the parties are put back in their original position, see the second paragraph of the present Article. It follows from the rule in paragraph (1) that the former owner has the position of a lessor when ownership passes back. The point of the second paragraph, however, is to clarify that the new owner (who is now no longer an owner) is discharged. The rule will typically apply when the contractual relationship under the sales contract is terminated, perhaps for the very reason that the lease contract was an unexpected burden on the buyer, implying a substantial non-performance of the seller's obligations. The right to terminate could lose much of its effect if the buyer were held liable to the lessee even after termination. The rule also applies where the seller agrees to termination of the contractual relationship, irrespective of the buyer's right to terminate. The term 'reversal' is chosen in order to indicate that there must be a close connection, as to both time and motivation, between the first and the second change in ownership. If the new owner, after some time, re-sells the goods to the former owner there is no reason why the main rule in the first paragraph should not apply. A qualification is made concerning performance already rendered at the time of reversal. It would in many cases be too complicated to put the parties back into their original positions regarding such performance. Obliging the lessee to compensate for or return performance rendered by the new owner during the period of change of ownership up until reversal, leaving the lessee with recourse to the original lessor, would further entail an unacceptable risk on the side of the lessee.

Illustration 3

The facts are the same as in Illustration 1, except that after two weeks the new owner Z terminates the contractual relationship under the sales contract for fundamental non-performance, on learning of the lease between X and Y. Z has no liability under the lease contract and Y has no claim against Z even if it later turns out that X is unable to perform the obligation to repair the damaged container.

D. The lessee does not have possession of the goods

Possible claims against the new owner. The rule under paragraph (1) of the present Article applies only when the lessee has possession of the goods at the time ownership passes. If the lessee does not have such possession no claim against the new owner can be based on this provision. However, there may be a stipulation in the sales contract in favour of the lessee as a third party to the effect that the lessee has the same rights and claims against the new owner as the lessee has under the contract for lease with the former owner. A seller of goods will often be interested in including a stipulation like this in the sales contract in order to avoid non-performance of obligations under the lease contract. A possible claim under the rules on non-contractual liability against a new owner in bad faith depends on the provisions in Book VI (Non-contractual Liability arising out of Damage caused to Another). Where ownership of the goods is transferred before the lessee has possession of the goods and the new owner does not agree to be bound by the lease contract, this will normally amount to non-performance of an

obligation under the lease contract, and the lessee may pursue the ordinary remedies for non-performance against the lessor, i.e. the former owner.

Illustration 4

X leases to Y five containers for industrial waste for a period of one year. Before the containers are made available to Y, X sells the containers to Z. The containers are brought to Z's premises. Z is not substituted as a party to the lease contract. Y can terminate the contractual relationship with X under the lease contract for fundamental non-performance and may also claim damages from X.

E. Registration of rights

Priority of rules on registration. For some categories of goods, typically aircraft and ships, there are registers of rights in the goods. Registration may have effect with regard to good faith acquisition of rights, protection of rights, and priority between conflicting rights. Such rules have priority over the rules of the present Article. This follows directly from the rules concerned, and it has not been found necessary to state this explicitly in the present Article.

F. Lessor is not owner

The rules apply accordingly. This Part of Book IV applies also where the lessor is not the owner of the goods but has some other right to enter into a lease contract, cf. Comment J to IV.B.-1:101 (Lease of goods). The lessor may for example be the holder of a usufruct right. The rules in the present Article apply accordingly if the lessor's right in the goods is transferred to someone else. The rules also apply if a lessor has subleased the goods and then transfers the original lease contract. This follows from the third paragraph of the present Article.

IV.B.-7:102: Assignment of lessee's rights to performance

The lessee's rights to performance of the lessor's obligations under the contract for lease cannot be assigned without the lessor's consent.

COMMENTS

A. Lessee's rights not assignable

Exception from the general principle. According to III.-5:105 (Assignability: general rule), all rights to performance are assignable except where otherwise provided by law. The rule in the present Article is an exception to the general principle, as the lessee's rights to performance of obligations under the contract for lease cannot be assigned without the lessor's consent. There are two different reasons for this exception, both of them related to the lessee's obligation of care, maintenance etc. Firstly, the lessor may rely on the lessee's personal qualifications in many lease contracts. The lessor may have interests in the goods beyond the mere economic value and hence does not want to see the goods left in the hands of persons who do not have the professional or personal ability

to handle the goods appropriately. There may also be situations where the lessor remains liable as an owner towards third parties for damage caused by the goods. This makes the interest in having control over who is using the goods even more acute. Secondly, several of the obligations regarding care, maintenance etc. can only be performed by a person having physical control of the goods. An assignment of the lessee's rights under the contract without a corresponding substitution of the assignee as a debtor could therefore imply a problematic division of the contractual position as lessee. A general rule allowing for the substitution of a third party as lessee without the lessor's consent is not acceptable. One alternative could be to differentiate the rule and accept assignment in contracts for lease where the lessor's interests are predominantly of an economic character, but such a rule would be more complicated. It is thought better to leave it to the parties to include a right of assignment in their contract where this right is required by the lessee and is acceptable to the lessor. An agreed right to assignment can be fine-tuned, including for example a requirement that the lessor's consent must not be withheld without good reason.

IV.B.-7:103: Sublease

- (1) The lessee may not sublease the goods without the lessor's consent.*
- (2) If consent to a sublease is withheld without good reason, the lessee may terminate the lease by giving a reasonable period of notice.*
- (3) In the case of a sublease, the lessee remains liable for the performance of the lessee's obligations under the contract for lease.*

COMMENTS

A. Right of use and the lessee's personal qualities

1. General. The importance of the lessee's personal qualities varies considerably from contract to contract. The lessee is liable as a party to the contract even if other persons use the goods. In some cases, however, the lessor's interest is not merely a matter of economic rights against the lessee (see also Comment A1 to the preceding article). The lessor may for example fear damage to unique goods or wish to avoid time-consuming repair work or conflict with the lessee as a result of careless or unqualified use. An owner leasing a precious heirloom to a relative to wear at a wedding is unlikely to accept that the lessee hand the object over to some other person, unknown to the owner. On the other hand, a business enterprise leasing bicycles to tourists will as a rule not put much weight on the lessee's personal qualities. The parties may agree on who may use the goods or the qualifications required to make use of the goods, e.g. that a car must not be driven by a person without a driver's licence. It may also follow from the circumstances that the lessee will not use the goods personally, e.g. where a machine is leased by a large business enterprise. Normally, the situation will be that the goods are used under the lessee's control, whether it is by the lessee personally or the lessee's family members, employees etc. It is not considered necessary to express this in a separate provision.

B. Sublease

2. Sublease only with consent. If the lessee enters into a contract with a third party making the goods – partly or wholly – available for this party’s use against remuneration, it is a sublease. The lessee should not be allowed to sublease the goods without the lessor’s consent, unless agreed otherwise at the time of conclusion of the contract or at a later date. The sublease typically implies that the goods will no longer be under the lessee’s control, as the sub-lessee is independent in relation to the lessee. The lessor may have objections to such a lack of control over and supervision of the use of the goods, notwithstanding the fact that the lessee remains liable as a party to the original lease contract. Further, the lessor may see the sublease as not conforming with the purpose of the lease contract: the lessee was given a right to use the goods; now the lessee benefits not from the use, but from the income raised by the sublease transaction. In some cases a sublease may even be in competition with the lessor’s own lease business.

3. Withholding of consent and extraordinary right of termination. The lessee can have a legitimate interest in subleasing the goods, for example where the contract for lease is made for a long period and the lessee can no longer use the goods due to changed circumstances. Subleasing may be the only way to benefit from the goods – goods for which the lessee must still pay rent. At the outset the consequences of such a development must be borne by the lessee. However, if the lessor has no good reason to withhold consent to a sublease, the balancing of the parties’ interests should lead to an extraordinary right for the lessee to terminate the relationship with the lessor under the lease contract. This is the rule stated in the second paragraph of the present article. The lessee may terminate the relationship by giving reasonable notice, thus being freed from the obligations under the contract for the remaining period. The lessor has no claim for damages for early termination. On the other hand, the lessee’s termination is not a remedy for non-performance. The lessor is under no obligation to consent to a sublease, with or without good reason. Some typical objections to a sublease are mentioned under Comment B, justifying the general requirement of consent. If, in a particular case, such objections are not relevant or are of only limited importance, it may be that there is not sufficiently good reason to withhold consent to a sublease under this rule. The relative weight of the inconveniences to the lessor compared to the benefits to the lessee of a sublease should also be taken into account.

C. Sublease, assignment of rights and transfer of the contractual position

4. Sublease distinguished from assignment and transfer. A sublease does not bring new parties into the contractual relationship between lessor and lessee. Obligations and rights under the contract for lease still lie between lessor and lessee. The situation is different where the lessee wants to assign the rights under the contract or wishes to transfer the entire contractual position, obligations and rights included, to another person. These questions are dealt with in IV.B.–7:102 (Assignment of lessee’s rights).

5. Lessor remains liable in case of sublease. For pedagogical reasons, it is stated in the third paragraph of the present Article that the lessee, in the case of a sublease, remains liable for performance of the lessee's obligations under the lease contract.

PART C. SERVICES

CHAPTER 1: GENERAL PROVISIONS

Section 1: Scope

IV.C.–1:101: Supply of a service

(1) This Part of Book IV applies:

(a) to contracts under which one party, the service provider, undertakes to supply a service to the other party, the client, in exchange for a price; and

(b) with appropriate adaptations, to contracts under which the service provider undertakes to supply a service to the client otherwise than in exchange for a price.

(2) It applies in particular to contracts for construction, processing, storage, design, information or advice, and treatment.

COMMENTS

A. Scope

A contract for services is defined in Annex 1 as “a contract under which one party, the service provider, undertakes to supply a service to the other party, the client”. However, the main application of this part of Book IV is to contracts imposing an obligation on a party to supply a service in exchange for remuneration (paragraph (1)(a). It applies only “with appropriate adaptations” to gratuitous contracts for services (paragraph (1)(a). A later Article (IV.C.–2:101 (Price)) provides that if a business supplies a service it is entitled to a price. However, this is just a default rule: the parties can contract out of it and agree that the service is to be provided gratuitously.

An obligation to supply a service is imposed if a party (the service provider) is bound to perform work undertaken according to the specific needs and instructions of another party (the client). The work will require in any event the supply of labour and may also involve the input of materials and components. The outcome of a service can be, but need not be, a tangible immovable structure, a corporeal movable or an incorporeal thing. Services falling within the scope of application of this Part are, for instance, provided by architects, banks, building and civil engineering contractors, carpenters, consultants, doctors, dry cleaners, estate agents, fashion designers, gardeners, garages, information

technology providers, interior decorators, lawyers, plumbers, researchers, storers, trainers and many others.

Paragraph (2) lists the types of service contracts which are covered more specifically in later Chapters of this Part. The general rules on service contracts are applicable to such contracts, but some of these rules are particularised or modified in the specific Chapters.

B. Generality

A significant feature of the present Part, compared to many national laws, is its generality. It does not draw distinctions at the primary level of classification between storage contracts and other service contracts, or between contracts for the provision of intellectual services or material services. It does, however, expressly exclude certain types of contract. See the following Article.

C. Relation to Parts I to III

This Part deals with service contracts and the rights and obligations arising out of them. The rules of Parts I to III apply generally to contracts and the rights and obligations arising out of them. These general rules apply to service contracts and do not have to be repeated in this Part. However, they may be particularised or modified by the rules in the present Part, having regard to the particular context of the supply of a service.

IV.C.–1:102: Exclusions

This Part does not apply to contracts in so far as they are for transport, insurance, the provision of a security or the supply of a financial product or a financial service.

COMMENTS

The contracts excluded by this Article are of great importance to practice, but there are powerful reasons for not including them. Contracts for insurance and guarantee are governed by their own sets of provisions in these model rules. Contracts for financial services and transport are of a specialised nature and are subject to, or likely to be subject to, initiatives at EU level. The words “in so far as” leave room for the rules on mixed contracts to operate (see II.–1:108 (Mixed contracts)). This means, for example, that a contract for the performance of a maintenance service on a movable and the transport of the movable would be within the scope of this Part so far as the maintenance service was concerned.

The exclusions in this Article are without prejudice to the general exclusions in Book I. One such exclusion is employment relationships. Employment contracts raise highly political issues relating to the protection of employees. They also have many specific features and particularities which would make it difficult to include them within the general rules on service contracts.

Section 2: Other general provisions

IV.C.–1:201: Structure

(1) Chapter 2 of this Part applies in relation to all service contracts within the scope of this Part, including contracts for construction, processing, storage, design, information or advice, and treatment.

(2) Chapters 3 to 8 contain more specific rules in relation to contracts for construction, processing, storage, design, information or advice, and treatment.

(3) In the case of any conflict the rules in Chapters 3 to 8 prevail over the rules in Chapter 2.

COMMENTS

This Article is intended merely to resolve any doubts about the relationship between Chapter 2 and the subsequent Chapters of this Part. The important point is that the general rules for all service contracts in Chapter 2 apply to the specific types of service contract covered in the subsequent Chapters, subject to any particularisation or adaptation in those Chapters.

IV.C.–1:202: Derogation

The parties may exclude the application of any of the rules in this Part of Book IV or derogate from or vary their effects, except as otherwise provided in this Part.

COMMENTS

This Article makes it clear that the rules in this Part are merely default rules unless otherwise provided. It is a particular application of the principle of party autonomy in II.–1:102 (Party autonomy). The application of that principle is particularly important in relation to service contracts because many such contracts are in practice governed by carefully drawn up contract terms – very often based on standard terms developed for a whole industry or sector. The result is that the application of default rules may be rather infrequent in relation to certain types of service contract.

There are few exceptions to the general rule in this Article. Some later Articles are by their nature not susceptible to exclusion or derogation by the parties. This is the case for scope provisions and definition provisions, which exist for internal purposes. Apart from such Articles, the only provisions which are mandatory are a number of provisions in the Chapter on Treatment which are designed to protect essential interests of the patient.

CHAPTER 2: RULES APPLYING TO SERVICE CONTRACTS IN GENERAL

IV.C.-2:101: Price

Where the service provider is a business, a price is payable unless the circumstances indicate otherwise.

COMMENTS

A. General idea

This Article imposes an obligation on the client to pay a professional service provider a price for the service the latter agrees to perform. Depending on the type of service, there are various methods of determining the price to be paid under a service contract. For some services it is customary to agree on the payment of a fixed price.

Illustration 1

A building constructor is commissioned by the local authorities to build an extension wing to the town hall. The parties agree that the work will be carried out for the total sum of € 800,000.

In other cases the service provider may be paid on the basis of an agreed tariff, such as an hourly rate.

Illustration 2

The owner of a house asks a painter to paint all ceilings, walls and doors of the house. The parties agree that the painter will be paid €12.50 per hour of work done.

Illustration 3

A meat trader agrees with a storer that the latter will store a shipment of Argentinean beef for the price of € 35.00 per ton per week.

Sometimes the agreement will be that no price is payable unless a result is obtained.

Illustration 4

A solicitor agrees with the victim of a work accident that she will try to obtain financial compensation from the victim's employer for all loss suffered as a result of the accident. The parties agree that the solicitor will be paid a percentage of the compensation obtained and that she will not be paid for the legal services rendered if no compensation is obtained.

It may happen that the parties do not state a price in the contract. The reason for this may be that – as is the case with some services – it is not possible to determine the price prior

to the conclusion of the contract. The fact that the parties failed to determine a price does not mean that there is no service contract. The service provider will simply be entitled to payment of the price in accordance with the general rule in II.–9:104 (Determination of price). This provides that the price payable is the price normally charged in comparable circumstances at the time of the conclusion of the contract or, if no such price is available, a reasonable price. This will result either in a fixed price or in a price to be determined on the basis of a generally charged tariff.

Illustration 5

A doctor agrees to perform a vasectomy on a patient. The parties did not discuss the financial aspects of the operation.

In this example, the doctor may charge the patient for the operation, but will have to observe the generally applicable tariffs.

Illustration 6

An architect agrees to design a new office for a law firm. When the design is completed, the architect finds a builder who is prepared to carry out the work for € 1,500,000.

In this example, the architect may charge the law firm for the design services, even if the parties did not explicitly agree in advance on payment. Assuming that it is general practice that an architect is paid 10 per cent of the price to be paid for the construction of the designed building, the fee for the design service will be € 15,000.

B. Only unless otherwise agreed

This is only a default rule. The parties can contract out of it. A business can agree to perform a service gratuitously. However, the mere fact that no price is stated in the contract will not be sufficient for such contracting out.

IV.C.–2:102: Pre-contractual duties to warn

(1) The service provider is under a pre-contractual duty to warn the client if the service provider becomes aware of a risk that the service requested:

- (a) may not achieve the result stated or envisaged by the client,*
- (b) may damage other interests of the client, or*
- (c) may become more expensive or take more time than reasonably expected by the client.*

(2) The duty to warn in paragraph (1) does not apply if the client:

- (a) already knows of the risks referred to in paragraph (1); or*
- (b) could reasonably be expected to know of them.*

(3) If a risk referred to in paragraph (1) materialises and the service provider was in breach of the duty to warn of it, a subsequent change of the service by the service

provider under IV.C.–2:109 (Unilateral variation of the service contract) which is based on the materialisation of the risk is of no effect unless the service provider proves that the client, if duly warned, would have entered into a contract anyway. This is without prejudice to any other remedies, including remedies for mistake, which the client may have.

(4) The client is under a pre-contractual duty to warn the service provider if the client becomes aware of unusual facts which are likely to cause the service to become more expensive or time-consuming than expected by the service provider or to cause any danger to the service provider or others when performing the service.

(5) If the facts referred to under paragraph (4) occur and the service provider was not duly warned, the service provider is entitled to:

(a) damages for the loss the service provider sustained as a consequence of the failure to warn; and

(b) an adjustment of the time allowed for performance of the service.

(6) For the purpose of paragraph (1), the service provider is presumed to be aware of the risks mentioned if they should be obvious from all the facts and circumstances known to the service provider, considering the information which the service provider must collect about the result stated or envisaged by the client and the circumstances in which the service is to be carried out.

(7) For the purpose of paragraph (2)(b) the client cannot reasonably be expected to know of a risk merely because the client was competent, or was advised by others who were competent, in the relevant field, unless such other person acted as the agent of the client, in which case II.–1:105 (Imputed knowledge etc.) applies.

(8) For the purpose of paragraph (4), the client is presumed to be aware of the facts mentioned if they should be obvious from all the facts and circumstances known to the client without investigation.

COMMENTS

A. General idea

The primary purpose of this Article is to impose a duty to warn on the parties prior to the conclusion of the service contract. This duty relates to typical risks that may occur after the conclusion of the contract once the services process has started. Occurrence of these risks would go to the very heart of the contract. The service provider is to warn the client about the risks that are identified in paragraph (1), and the client is to warn the service provider about the risks mentioned in paragraph (4).

Illustration 1

A supplier of computer networks is requested by the management of a hospital to install a tailor-made network on the basis of a design made on behalf of the hospital. If the supplier were to follow the design exactly, the computer network would not serve the intended purposes.

This is an example of a risk against which the service provider may have to warn, subject to the test of paragraph (6), which is explained below.

Illustration 2

A civil engineering constructor offers to excavate a piece of land and to remove the excavated soil to a nearby depot by truck. The constructor offers to perform the service for a fixed price within a fixed period of time. The offer is based on the constructor's assumption that the subsoil of the land is sufficiently condensed to support the constructor's large and heavy excavators without additional measures. This assumption is made known to the client. Geo-technical data on neighbouring land seem to confirm the constructor's point of view, but the client has specific knowledge of the fact that the subsoil of his land contains large pockets of soft and unstable clay. Extra measures are required to support the excavators, which will slow down the service and will make the service more costly.

This is an example of a risk which may give rise to a duty on the client to warn, subject to the test of paragraph (7), which is explained below.

These mutual duties to warn have in common that the parties only have to warn each other if the risks are obvious to the party subject to the duty, or if they are actually discovered by that party. This principle is reflected in paragraph (1) in conjunction with paragraph (6) as regards the service provider's duty to warn and in paragraph (4) in conjunction with paragraph (7) as regards the client's duty to warn.

An additional requirement that needs to be fulfilled under paragraph (4) in order to impose on the client a duty to warn, relates to the unusual character of the risk. This additional requirement is to prevent the client from being under a duty to warn if the risk mentioned in paragraph (4) is considered to be obvious to the service provider as well. This can be illustrated by using a modification of *Illustration 2* above:

Illustration 3

A civil engineering constructor offers to excavate a piece of land and to remove the excavated soil to a nearby depot by truck. The constructor offers to perform the service for a fixed price within a fixed period of time. The offer is based on the constructor's assumption that the trucks will be able to approach and leave the land via a shortcut through a residential area. The client knows that the local authorities will not allow heavy trucks to drive through that area, which will slow down the service and will make the service more costly.

The mirror image of this approach can be found in paragraph (2) which negates the service provider's duty to warn in the event that a risk is either known to, or obvious to, the client.

Illustration 4

A hairdresser is asked by a customer to dye her hair. The hairdresser proposes to perform the service by using 'Inecto' hair dye. The hairdresser does not inform the customer that some customers in the past suffered from an allergic reaction to the use of 'Inecto' hair dye. The customer in question did experience such an allergic reaction some years ago, when another hairdresser treated her with 'Inecto'. However, the customer does not mention that earlier experience to the hairdresser.

The additional purpose of this Article – closely linked to its primary purpose – is to stimulate the parties to exchange important information prior to the conclusion of the contract. This information particularly relates to the wishes and needs of the client for which the service is required as well as to important circumstances in which the service is to be performed.

Illustration 5

A specialised lift contractor is asked to supply and install four lifts in an office building under construction at a fixed price. In order to be able to make the offer, the contractor needs to study the plans of the building, showing the specifications as regards the lifts. The contractor will also need to know at what time during the building process the lifts are to be installed and what other contractors will be present on the building site at that time in order to take into account possible interferences with the job.

This information needs to become available to the extent that it enables the service provider to offer a tailor-made service to the client and to explain the most important characteristics of the service offered. This is the point where the connection with the service provider's pre-contractual duty to warn becomes relevant, for the extent of *that* duty depends on risks that are obvious or are discovered by the service provider given the information the service provider should have collected in order to make an informed offer to the client as regards the service that can be supplied. A modification of *Illustration 1* may explain this.

Illustration 6

A supplier of computer networks is requested by the management of a hospital to make an offer for installing a tailor-made network on the basis of a design made on behalf of the hospital. The supplier studies the design for the purpose of preparing the offer. If this investigation brings to light that the hospital will not be able to use the computer network for the intended purposes, due to a failure in the design, the supplier must warn against that risk.

The risks to be discovered also relate to risks inherent in the service that are independent of the client's needs and the circumstances surrounding the future performance of the service.

Illustration 7

A doctor is asked to perform a vasectomy on a patient. The doctor will have to warn the patient that he will not be infertile immediately after the operation. The doctor will have to do so, whether or not the patient has told the doctor that the operation is to be performed for the purpose of becoming infertile and irrespective of the question whether the patient has a steady relationship with a female partner.

Once the client has been offered the service and has been warned against the risks mentioned in paragraph (1), the client will be able to make an informed decision on the conclusion of the service contract. Moreover, having received the offer the client will be able to perform the pre-contractual duty to warn under paragraph (4). This is in fact what the client should do in the example given in *Illustration 2* above. In that example, the client must share the client's special knowledge with the civil engineering contractor prior to the conclusion of the contract.

A service is usually offered to a particular client and tailor-made to satisfy the needs of that client.

Illustration 8

A company specialised in the development of industrial software is asked to design a computer program that will enable the client, a medical laboratory, to compare medical test results.

However, it is also possible that standard services are offered to the public in general.

Illustration 9

A garage offers to remove and change standard exhaust pipes at the fixed price of € 50.

The situation in *Illustration 9* will probably not lead to an extensive exchange of information between the service provider and a potential client, something which will most likely happen in the situation in *Illustration 8*. Nevertheless, if a rather standard service is offered to a group of clients, the duties under the present Article remain imposed on the service provider. These duties will still have to be fulfilled, bearing in mind the average purposes, conditions, circumstances, characteristics, and risks that are relevant to the average client being a member of this group.

Non-performance of a pre-contractual duty to warn under paragraph (1) or (4) will sometimes lead to the aggrieved party avoiding the contract for mistake or claiming damages for loss caused by the mistake, or both. Other remedies may also be available. The rules of paragraphs (3) and (5) supplement the normal rules on remedies. They deal with the frequently occurring situation that non-disclosure of information prior to the conclusion of the service contract causes the service to become more expensive and to take more time once the information is revealed after the conclusion of the contract.

Paragraph (3) protects the client from being confronted with a claim for compensation for extra costs and extension of time if the service provider failed to fulfil the duty to warn under paragraph (1). It prevents the service provider from unilaterally varying the terms of the contract under IV.C.-2:109 (Unilateral variation of the service contract) on the basis of the materialisation of a risk of which the client should have been warned in advance. This does not apply however if the service provider proves that the client would have entered into the contract even if warned about the risk prior to the conclusion of the contract. If the service provider succeeds in proving that, the provisions of IV.C.-2:109 (Unilateral variation of the service contract) will apply.

Paragraph (5) allows the service provider to claim damages and extension of time if the client failed to warn under paragraph (4).

B. Interests at stake and policy considerations

Imposing pre-contractual duties to warn on parties to a service contract raises several issues that need to be considered.

The first issue is whether pre-contractual duties to warn are to be imposed on the parties to a service contract at all. One may argue that a duty should not be imposed on a party unless that duty was freely assumed, either impliedly or expressly, at the time of conclusion of the contract. Another argument against such duties would be that they would put too much of a burden on the parties' negotiations prior to the conclusion of the service contract. On the other hand it can be assumed that both the client and the service provider will in any event be involved in a process of information exchange whenever they negotiate the conclusion of a service contract. The client will explain what is needed and the service provider will give details about the most important characteristics of the service which can be provided. Only such an exchange of information will enable the service provider to make an offer to the client, which will allow the latter to make an informed decision on the conclusion of the service contract. In the light of the information received from the other party, each party may find out that the other party is making an erroneous assumption as to the benefits that can be derived from the contract. The imposition of a duty to warn in such situations will hardly impose extra costs. It may even be beneficial to the party issuing the warning in view of the fact that a warning may prevent future disputes, which might arise once the aggrieved party finds out that the contract was concluded under a wrong assumption. The standard economic reasoning for a pre-contractual an obligation to inform is that the costs of collecting information, its supply to the other party, as well as its digestion by that other party are less than the costs of wrong decisions (the chance of a wrong decision times the damage caused by that decision, which is the difference between what a party expected to get and what it actually obtained).

A second issue is what should trigger an obligation to warn, having regard for the information that is exchanged during the negotiations. One may be inclined to draw a parallel with the approach taken to the service provider's contractual obligation to warn. There, the analysis of arguments leads to the solution that the obligation is to be triggered

by inconsistencies in the information or directions supplied by the client if it is expected that following the information or directions may lead to a risk that would go to the very heart of the contract from the client's perspective. That approach may be taken here too, both as regards the service provider's and the client's pre-contractual an obligation to warn. On the other hand, one may question whether the parallel can indeed be drawn, for the contractual obligation is to be considered not only in the framework of a contract already negotiated and concluded, but also in the perspective of a service that is either in process or already completed. It is then obvious that triggering the contractual obligation to warn is related to fundamental risks that may compromise the desired outcome of the service process. It could be argued that this is not what a pre-contractual an obligation to warn should be about and that, instead, triggering such duties should be related to the desired outcome of the process of negotiating the contract.

Assuming that pre-contractual duties to warn are to be imposed on the parties to a service contract and that it is possible to establish in which situation they are to be imposed, a third issue has to be resolved. This issue involves the question how alert the parties should be during the pre-contractual information exchange in order to be able to signal assumptions on the part of the other party that may give rise to a pre-contractual duty to warn. Here, the same questions and arguments that are raised for the contractual obligation to warn may be put forward. Do the parties need to focus on wrong assumptions of the other party? Do they have to search for such assumptions? If that were to be accepted, the process of information exchange would become very costly. These costs might even be incurred in vain, if the negotiations do not result in a contract. And even if they do result in a contract, they will have made the service more costly in any event. On the other hand, an extended pre-contractual duty to investigate one another's assumptions would prevent parties from entering into a contract that later on turns out to be less profitable than expected prior to the conclusion of the contract.

A fourth issue involves the question whether a pre-contractual duty to warn is to be imposed on a party if the other party is more competent than the average party or if it already knows of the problem to which the warning should refer. This question is particularly relevant in the context of services, where clients are frequently assisted by someone else who has – or is deemed to have – the capacity of a professional and competent adviser. The issue is also raised with respect to the contractual obligation to warn of the service provider. One argument would be that imposing a pre-contractual duty to warn in such circumstances would not only be unnecessary but also become very costly. On the other hand, it implies that one has to make a choice between an unnecessary warning and the occurrence of disappointment that is not discovered in time.

The previous issues give rise to a fifth and final issue. Parties will only be able to analyse information and give appropriate warnings on the basis of it if such information has actually been exchanged during contract negotiations. The question to be answered is, therefore, whether a pre-contractual duty to exchange information (going beyond the general pre-contractual information duties imposed in Book II, Chapter 3) is to be imposed on the parties, and what the content of that information should be. This question

is closely related to the first issue raised above, questioning the need to adopt mutual pre-contractual obligations to warn. There it has been argued that pre-contractual exchange of some information is a *conditio sine qua non* if parties contemplate the conclusion of a service contract. This will particularly be the case if the service required is not standard. The information will relate to both the client's needs and to the solutions the service provider can offer to fulfil these needs. It is doubted whether parties will be able to contract with one another without such information. By the same token, it is doubted whether they would need more information in order to consider one another's assumptions, which may eventually result in a warning causing additional information exchange.

C. Preferred option

The present Article imposes pre-contractual duties to warn on both parties to a service contract. It is better to have such an Article and to limit carefully the extent of the duties it imposes than to have no provision at all. Furthermore, the duties are firmly embedded in the development of pre-contractual duties to inform, a development that has taken place and is still taking place in the jurisdictions investigated and in European private law. This development is already reflected in Book II, Chapter 3 and in the provisions on mistake in Book II, Chapter 7. It has, however, been considered necessary to deal with these duties in an Article in the present Part, in addition to those more general provisions. In service contracts pre-contractual information exchange is of crucial importance. Clear rules are needed, which are adapted to the particular context of the interrelationship between the information exchange prior to the contract and the performance of the service subsequent, to conclusion of that contract.

As to the question what kind of problems should trigger the parties' pre-contractual duty to warn, the Article follows the contractual counterpart of the obligation of the service provider under IV.C.-2:108 (Contractual obligation of the service provider to warn). This is based on the assumption that fundamental risks which – if they occur on conclusion of the contract – would compromise the desired outcome of the service process, are risks a party would want to know of prior to the conclusion of the contract. If that party were not to know of such risks at that time and if the risks occurred later on, the party would most likely argue that it would not have entered the contract or would have done so only on fundamentally different terms. An example of such a risk is given in *Illustration 1* above.

As to the questions how alert the parties should be during the pre-contractual information exchange and whether they should be on the lookout for wrong assumptions, the Article does not expect the parties to make investigations. The duty is only to warn of what the party is aware of. There is a logical difficulty in imposing a duty to warn of something of which one is not aware. However, the service provider is presumed, under paragraph (6), to be aware of risks if they should be obvious from all the facts and circumstances known to the service provider, considering the information supplied by the client and the circumstances in which the service is to be carried out. The approach implies that the service provider will have to examine carefully the client's information, including the more general information about the client's needs, because it will be the basis of any

tailor-made offer. In doing this, the service provider will have to think of risks that are inherent in the service and that are independent of either what the client's needs are or the circumstances in which the service is to be provided. Wrong assumptions of the client, which will not escape the service provider's attention on studying the information as thoroughly as is necessary to prepare the offer, have to be mentioned to the client. Any active inspection aimed at discovering wrong assumptions is therefore not required.

Illustration 10

An engineer is requested by a factory to make an offer for adapting a production machine following specific functional, technical, and production requirements provided by the factory. The engineer studies the requirements for the purpose of preparing his offer. Only if this investigation at the same time brings to light that, due to an inconsistency in the functional and technical requirements, the adapted production machine will not be able to meet the production requirements, must the engineer warn the factory against that risk.

As to the client's pre-contractual duty under paragraph (4), a similar approach is adopted. The client is presumed under paragraph (8) to be aware of the relevant facts if they should be obvious from all the facts and circumstances known to the client without investigation. Again, this implies that the client will have to analyse the service provider's information contained in the latter's offer carefully, given that contractual obligations will be incurred once the offer is accepted. Wrong assumptions of the service provider, which will not escape the client's attention on studying the offer as thoroughly as is necessary to make an informed decision as to the acceptance of the offer, have to be mentioned to the service provider. Again, any active inspection aimed at discovering wrong assumptions of the service provider is not required.

Illustration 11

A management training agency is requested by a company to make a fixed-price offer for a three-day training of the company's financial staff. The company wants an 'all-in' service, meaning that the fixed price offered not only covers training fees and additional training costs, but also catering and accommodation costs. Having received the offer of the agency, it becomes clear to the company that the agency has made a computation mistake to its own detriment.

In this example, the client has become aware that if the service provider is not told about the computation mistake, the supply of the service will become more costly for the latter. The client therefore must warn the agency.

The same approach is adopted for the purpose of establishing whether a party's competence or knowledge is such as to negate the other party's duty to warn. First, as regards the client's duty to warn, paragraph (4) states that the duty only concerns an 'unusual' risk. The word 'unusual' is used in order to negate the client's pre-contractual duty to warn in the event of foreseeable facts and circumstances, which the service provider should take into account – as stated in paragraph (1) in conjunction with

paragraph (6) – on studying the client’s information as thoroughly as is necessary to prepare the tailor-made offer.

Illustration 12

A meat trader agrees with a storer that the latter will store a shipment of beef. The trader does not inform the storer that meat will perish if it is not stored in frozen condition. There is no breach of the duty to warn as this is a usual and obvious risk.

Paragraph (7) gives an additional clarification to the question whether and, if so, to what extent the client’s own competence or the competence of any other person assisting the client at the pre-contractual stage can be taken into account in determining whether the client can reasonably be expected to know of a risk. The principle adopted is that the client’s competence by itself is insufficient to support the prima facie conclusion that the client can reasonably be expected to know of a risk at the pre-contractual stage. The same goes when someone else advises the client: The competence of that other person does not automatically lead to the conclusion that the client can reasonably be expected to know of the risk at the pre-contractual stage. This is particularly to protect the interests of Small and Medium-sized Enterprises (SME’s) and consumers that are advised – often for free – by their relatives or friends. The situation becomes different, however, if a client specifically hires a professional adviser for the specific purpose of acting as an agent during the pre-contractual stage of the service contract. Any knowledge or competence of such an agent will be imputed to the client under paragraph (7) in conjunction with Article II.–1:105 (Imputed knowledge etc) and may amount to knowledge or reason to know of the client, which will then negate the service provider’s pre-contractual duty to warn under paragraph (2).

Finally, it is implied in paragraph (6) of the present Article that the service provider should collect information prior to the conclusion of the contract about what the client wants. As explained above (see Comments A and B), this involves information the exchange of which is already inherent in service contract practice.

The duties imposed by this article are related to the pre-contractual duty to inform under Book II, Chapter 3 and the similar duty that is implied in the provisions on mistake in Book II, Chapter 7.

D. Relation to other chapters of this part

The pre-contractual exchange of information between a service provider and client, as required under the present Article, will not always be relevant to the same extent to all types of services. Differences can be noted which are caused by the characteristics related to each type of service. An important aspect that has to be taken into account is that the client cannot always objectively expect to obtain certainty in advance as regards both the quality and the cost of the result that will be achieved through the service to be performed. The question whether or not it is possible to provide such certainty in advance depends on the ability to both identify and control all the factors capable of influencing

the result of the service and its cost. In general terms these factors are: (1) the particular needs of the client, (2) the service provider's solution that fits these needs, and (3) the surrounding circumstances in which that solution is to be applied in order to meet the client's needs. Pre-contractual exchange of information regarding these aspects *only* becomes relevant if one or more of these aspects are neither identified nor controlled sufficiently prior to the conclusion of the contract and – in the unfortunate event they present themselves after the conclusion of the contract – if they cause a substantial increase in the costs or a decrease in quality of the outcome of the service. The most prominent example of this is probably to be found in the field of construction contracts, given the particularities of a construction process, which will be discussed below after the following illustration:

Illustration 13

A regional authority requests a civil engineering contractor to make an offer for the construction of a flyover on the basis of a design prepared by the authority's planning department. The flyover is to be constructed in the vicinity of a motorway junction.

First, and this is also shown in the illustration, in construction one can see a strong interrelationship between the abstract factors referred to earlier. The solution to be applied by the contractor very much depends on the client's specific needs, given the particular surrounding circumstances in which the new building or other immovable structure has to be realised. This further explains why there is no such thing as a standardised construction service. Secondly, in theory it is possible to identify and control the result of the construction process in advance, provided the client's needs and the surrounding circumstances in which the building is to be built are thoroughly mapped and checked in advance, usually by means of a design that is supplied by or on behalf of the client to the contractor. Thirdly, given the ability of the parties to control the output of this technical process, they are also able to calculate and check in advance the total costs that will be incurred. This explains why it is very common in construction contracts to agree on a fixed price for the construction service. Fourthly, parties clearly have an interest in identifying and controlling both the quality and the costs of the result of the construction process as much as possible in advance: if they refrained from doing so as regards one or more of the aspects referred to above, they run the risk of facing considerable problems after the contract has been agreed on. For instance, they might find out that the real costs of the building exceed the agreed price. Also, the quality of the outcome or the timely performance of the construction project are likely to be endangered as a result of the contractor's solution being insufficiently attuned to the client's needs given the surrounding circumstances in which the building is to be realised.

Taken together, the above particularities are the reasons why it is common in construction to map out in detail – in advance – the client's needs and the technical solution to meet these needs, attuned to the surrounding circumstances in which that solution is to be applied by the contractor. The particularities further explain why there is a clear distinction between the pre-contractual stage on the one hand and the contract stage on

the other. Finally, the particularities show why pre-contractual exchange of information as required under the present Article is regarded to be most relevant. In order to be able to offer both a tailor-made solution and a fixed price for the construction of the building required by the client, the contractor needs to know in advance what the specific needs of the client and the particular surrounding circumstances are in which the construction service is to be performed.

A parallel can be drawn between the construction of a new building or other immovable structure and the situation in which a service is centred on an existing movable or incorporeal thing, which is the case in the event of a processing service or a storage service. However, as will be explained below, that parallel exists only to a certain extent. The parallel will be drawn for processing contracts, but the analysis is also applicable to storage contracts. Where appropriate, a parallel with other particular service contracts will be drawn.

As regards the processing of an existing movable or incorporeal thing, there is an interrelationship between the needs of the client, the processor's solution that fits these needs, and the surrounding circumstances in which that solution is to be applied by the processor in order to meet the client's needs. The following illustration shows this:

Illustration 14

A craft upholsterer agrees with a client to upholster the seats of six antique armchairs belonging to the client by using a special type of fabric selected by the client.

There is, however, a crucial difference with construction, in the sense that – apart from the particularities of the thing that is to be processed – there are hardly any influential surrounding circumstances in which the processing service is to be carried out. The costs and the results of the service entirely depend on the particularities of the thing, given the client's needs. Particularly if both that thing and the client's needs are rather standard, the absence of surrounding circumstances likely to influence the outcome of the service process will make it likely that the client's needs can be satisfied by supplying a standardised processing service, as is shown in the following examples:

Illustration 15

A car owner requests a garage to replace the exhaust pipe of his car.

Illustration 16

A dry cleaner agrees to dry clean a raincoat for a client.

In such cases, the duties under the present Article will likewise be limited to an exchange of standard information. Given that the processor, in many of these situations, is probably also able to offer a fixed price immediately after the client's needs are known and that the processor is sometimes even able to do so without performing a superficial inspection of the thing to be processed, the pre-contractual exchange of information will be very

similar to the one preceding the conclusion of a sales contract. This type of processing contract – and the scenario that is described for the conclusion of such contracts – also resembles contracts involving the supply of factual information under Chapter 7, an example of which is given in the following illustration:

Illustration 17

A pension fund agrees with the online data services department of the stock exchange that it will have continuous access to electronic information as regards the actual value of shares traded at the stock exchange.

The situation will become different, however, if the processing service is no longer standard, given the particularities of the client's needs and the thing that is to be processed. Pre-contractual exchange of information will then become more relevant and will probably be necessary if the processor is to be able to offer a fixed price. This will, for instance, be the case in the following example:

Illustration 18

An engineer is requested by a factory to make an offer for changing a production machine following specific functional, technical, and production requirements provided by the factory.

The situation may be very similar in the case of design contracts, as is illustrated in *Illustration 8*.

There is also another gradual difference between the construction of a new building or other immovable structure and the processing of an existing movable or incorporeal thing (this is, for instance, also where the parallel between processing contracts and storage contracts ends), for it will not always be possible to identify and control in advance the aspects that will influence the result of a processing service – either standard or tailor-made – due to which pre-contractual exchange of information regarding these aspects will become less useful. This will particularly be the case if pre-contractual exchange of information is not essential for calculating a fixed price that is to be paid for the processing service. In this situation, however, there will still be a clear distinction between the pre-contractual and the contractual stage of the processing service.

Illustration 19

The owner of a seventeenth century painting, which has been exposed to smoke and other damaging conditions for centuries, agrees with a specialist restorer to try to bring back the original colours of the painting without damaging it.

The position may be similar for contracts involving the supply of evaluative information under Chapter 7.

Illustration 20

A company involved in a difficult legal dispute requests a law professor to investigate the documents related to the dispute and to assess the company's chances of winning the dispute in court.

The distinction will become blurred if the factors that influence both the results *and* the costs of the processing service can no longer be identified and controlled in advance and the pre-contractual exchange of information will – again – become less useful for that purpose. Given that the processor in such a situation will probably not offer the performance of the service at a fixed price, the parties will hardly notice the passing of the pre-contractual stage of such a service.

Illustration 21

During an archaeological excavation, the shattered remains of a large collection of Roman pottery are discovered. The State contracts a specialised company to try to restore the collection.

This type of processing contract – and the scenario that is sketched out for the conclusion of such contracts – resembles contracts involving the treatment of persons under Chapter 8.

Illustration 22

A patient has suffered from an ongoing headache for several weeks and eventually decides to contact a doctor.

E. Remedies

If the service provider's pre-contractual failure to warn causes the service not to achieve the result stated or envisaged by the client (subparagraph (1)(a)), the latter will probably seek resort to a remedy under Book III, Chapter 3 on the basis of the service provider's non-performance of the main obligation under IV.C.–2:106 (Obligation to achieve result). As explained in Comment A to that Article, however, the obligation of that Article is not imposed on the service provider in every service contract. Another option may be to try to claim damages on the basis that the service provider failed to perform a *contractual* obligation to warn. That second route would also be an option for the client in the event that the risk mentioned in subparagraph (1)(b) occurs. A third option for the client – in the event that either the risk under subparagraph (1)(a) or under subparagraph (1)(b) is the result of the failure to warn – would be to try to avoid the contract on the basis of mistake. This option will sometimes be hypothetical, given that it may be impractical or unprofitable to stop a service process and invoke the rules on the effects of avoidance.

On the other hand, whether or not the client exercises the right to avoid the contract, damages may still be recovered under II.–7:214 (Damages for loss) for loss caused by the mistake. If the risk mentioned in subparagraph (1)(c) occurs, the client does not need to resort to a remedy but can simply block the service provider's claim on the basis of

paragraph (3), unless the service provider can prove that the client would have entered into the contract even if warned about the risk prior to the conclusion of the contract.

If the client fails to perform the duty to warn under paragraph (4), the service provider may either not achieve the result the client has in mind or damage other interests of the client in performing the service. In this case, the client might try to resort to a remedy on the basis that the service provider did not perform the obligations under the contract. Here, however, the client's failure to warn will prevent the client from resorting to a remedy for the service provider's non-performance to the extent that that failure caused the non-performance (see III.-3:101 (Remedies available) paragraph (3)). It is noted, however, that, after the conclusion of the contract, the service provider may come under a contractual obligation to warn under IV.C.-2:108 (Contractual obligation of service provider to warn) which concerns the same risk the client failed to warn about prior to the conclusion of the contract. In that case, the non-performance of that contractual obligation will give rise to remedies as explained in the Comments to that Article, in the event that they jointly caused the result envisaged by the client not to have been achieved.

If the client does not warn the service provider under paragraph (4), the latter may try to avoid the contract for mistake. This will, however, probably be as hypothetical as the client's option to avoid the contract in the case of the service provider's failure to warn under paragraph (1), for the risk that occurs due to the client's failure to warn is that the service has become more expensive and time consuming.

The service provider will probably want to carry on with the service and earn the fruits of the contract as long as there is compensation for the loss sustained. The service provider is unlikely to be able to seek damages for mistake under II.-7:214 (Damages for loss) if payment of a fee based on an hourly rate was agreed on at the time of conclusion of the contract, for in that case no loss will be suffered. However, if payment of either a fixed price or a fee based on a 'no result, no pay' basis was agreed on, II.-7:214 (Damages for loss) will become relevant. However, given that the situation described is in fact similar to what may occur if the client fails to perform a *contractual* obligation to co-operate, the service provider may also seek resort under paragraph (5) of the present Article. This means that the service provider can claim both compensation for the loss occurred and extension of time to perform the service.

IV.C.-2:103: Obligation to co-operate

(1) The obligation of co-operation requires in particular:

(a) the client to answer reasonable requests by the service provider for information in so far as this may reasonably be considered necessary to enable the service provider to perform the obligations under the contract;

(b) the client to give directions regarding the performance of the service in so far as this may reasonably be considered necessary to enable the service provider to perform the obligations under the contract;

(c) the client, in so far as the client is to obtain permits or licences, to obtain these at such time as may reasonably be considered necessary to enable the service provider to perform the obligations under the contract;

(d) the service provider to give the client a reasonable opportunity to determine whether the service provider is performing the obligations under the contract; and

(e) the parties to co-ordinate their respective efforts in so far as this may reasonably be considered necessary to perform their respective obligations under the contract.

(2) If the client fails to perform the obligations under paragraph (1)(a) or (b), the service provider may either withhold performance or base performance on the expectations, preferences and priorities the client could reasonably be expected to have, given the information and directions which have been gathered, provided that the client is warned in accordance with IV.C.–2:108 (Contractual obligation of the service provider to warn).

(3) If the client fails to perform the obligations under paragraph (1) causing the service to become more expensive or to take more time than agreed on in the contract, the service provider is entitled to:

(a) damages for the loss the service provider sustained as a consequence of the non-performance; and

(b) an adjustment of the time allowed for supplying the service.

COMMENTS

A. General idea

The parties to a contract are under a general obligation to co-operate to the extent that this can reasonably be expected for the performance of the obligations under the contract III.–1:104 (Co-operation). Paragraph (1) of the present Article particularises this obligation for the purposes of service contracts.

The client must, under paragraph 1(a) and (b), supply appropriate information and directions. These may involve information and directions promised to the service provider at the time of conclusion of the contract. Depending on the type of service, such information and directions may be expected to specify the client's expectations as regards the result to be achieved through the service. An example of this is given in the following illustration.

Illustration 1

A trader of vegetables agreed with a storer that 10 tons of vegetables are to be stored at a fixed price per ton per week. After the conclusion of the contract, the client must supply additional specifications to the storer as regards the type of vegetables and the manner of handling and preserving them.

The information and directions may also provide further details as to the circumstances in which the service is to be carried out.

Illustration 2

A management consultant agreed to investigate the logistics department of a large food production factory and to advise on a possible reorganisation of the department. Once the contract is concluded, the consultant needs to receive additional information from the factory as regards the age, education, job descriptions, and career development of the employees working in the department. She also needs to be informed about internal and external work processes.

Further information or directions may subsequently be required if the service provider encounters difficulties which prevent the achievement of the result envisaged by the client and which cannot be solved by the service provider without such information and directions.

Another particularisation of the client's general obligation to co-operate in the context of service contracts can be found in subparagraph (1)(c). It involves the obtaining of permits or licenses needed to allow the service to be performed lawfully. The obligation is imposed on the client if explicit wording to that effect is used in the contract. An obligation to that effect can also be implied if the service provider cannot obtain the permit or license required.

The obligations of the client under subparagraphs 1(a), (b), and (c) are subject to a necessity test. They arise only so far as necessary to enable the service provider to perform obligations under the contract. An example of a case where this test is deemed to be fulfilled, is provided in the following illustration:

Illustration 3

A company specialised in removing graffiti from concrete walls is hired by a bank to clean the walls of the bank's head office. The contract states that the bank will take care of all licences and permits required. After two days of cleaning, the cleaning company is instructed by local authorities to stop working because no permit has been granted. The cleaning company awaits instructions from the bank on how to proceed with the service.

Subparagraph 1(d) requires the service provider to give the client a reasonable opportunity to monitor the service process as it proceeds. This will give the client the opportunity to perform promptly the obligation to notify under IV.C.-2:110 (Client's obligation to notify anticipated non-conformity) if the client becomes aware that the service provider will fail to achieve the result envisaged by the client. It will also enable the client to give directions under IV.C.-2:107 (Directions of the client).

Illustration 4

An aged couple contracted with an architect to design the reconstruction of their mansion, which will enable them in the future to live and sleep downstairs. The

architect is to present his ideas and plans to the couple on a regular basis during the design process.

Subparagraph (1)(e) imposes an obligation on both parties. It may well be that the client has to perform specific obligations to co-operate throughout the service process, which then amounts to an iterative process of intertwined performances of both parties. Obviously, such a process will only lead to the result envisaged by the client if both parties co-ordinate the performances of their respective obligations. Again, however, this obligation to co-ordinate is subject to the application of the necessity test referred to above.

Illustration 5

The owner of a house wants to sell his house and contracted with an estate agent to find a buyer for that purpose. In order to be able to perform the service, the parties will have to make practical arrangements together in order to enable the estate agent to assess the value of the property and to allow potential buyers to visit the house for inspection at a time convenient to all parties involved.

Failure to perform any of the obligations under paragraph (1) will allow the aggrieved party to resort to the normal remedies for non-performance of a contractual obligation. In addition to the service provider's normal remedies, paragraphs (2) and (3) of the present Article contain further rules which may assist the service provider in the event of the client's non-performance of an obligation to co-operate.

If the client does not supply the information or directions required under subparagraph (1)(a) or (b), the effect will often be to prevent the service provider from knowing the client's expectations, preferences and priorities and hence from being able to achieve the result envisaged by the client. However, depending on the type of service contracted for, it may still be possible to proceed on the basis of the expectations, preferences and priorities the client could reasonably be expected to have. If this is the case, the service provider may try to earn the fruits of the contract by proceeding on that basis provided that the client is notified of this intention.

Illustration 6

A road constructor is carrying out the reconstruction of a road on the basis of a design provided by the regional planning authorities. The design requires that the subsoil of the road's foundation consist of a layer of sand of at least one metre. The information supplied to the constructor by the authorities warrants the presence of such a layer. After the road works have started, the presence of a vast amount of soft clay is discovered. The authorities fail to give the necessary directions to the constructor as to how to proceed. The constructor notifies the authorities that he will excavate the clay and replace it with sand.

This rule of paragraph (2) does not prejudice the service provider's right to resort to any of the normal remedies for non-performance of an obligation.

If the client resumes co-operation after a period of passivity – whether or not in response to a warning given by the service provider – or if the service provider pursues the performance of the contractual obligations under paragraph (2), it is likely that the service will have become more costly for the latter and that more time will be needed to achieve the result required. This will not cause problems if payment of a fee based on an hourly rate was agreed on at the time of conclusion of the contract. However, if payment of either a fixed price or a fee based on a ‘no result, no pay’ basis was agreed on, the service provider would incur a loss due to the client’s failure to co-operate.

Illustration 7

A factory agrees with a specialised engineer that the latter will adjust a machine owned by the factory at a fixed price. The job will take about two weeks. The parties also agree the date when the service will have to start. When the engineer wants to start work on the agreed date, factory employees tell him that he will not have access to the machine yet, ‘but that access will be granted soon’. The engineer has to keep himself available for the service, but loses time and money.

In this example, the service provider may claim compensation for the loss suffered as a result of the client’s non-performance of the obligation to co-operate under paragraph (3) of the present Article. Such a claim may include an extension of time to perform the service.

B. Interests at stake and policy considerations

A particularisation of the obligation to co-operate as regards service contracts raises several issues that have to be taken into account.

First of all, one might question the need to have specific obligations to co-operate in the present Part. Although the obligation to co-operate appears to be particularly relevant to service contracts, it might be argued that the general rule in III.–1:104 (Co-operation) is enough. On the other hand, one might argue that that rule is too general and that commercial practice needs more specific guidance in the context of a service contract.

A second issue to be dealt with concerns the extent to which the client in particular is to co-operate under a service contract. One might question whether the general criterion under III.–1:104 (Co-operation) (‘to the extent that this can reasonably be expected for the performance of the debtor’s obligation’) is precise enough in the context of service contracts. The obligation to co-operate under many service contracts is distinctly more intense than it is in most other contracts, because each party depends heavily on the other party’s co-operation to achieve its objectives. This is an argument in favour of stating an intense obligation to co-operate actively and loyally in order to achieve the objectives in view of which the contract was concluded. On the other hand, one might question whether a client should enable the service provider to earn the fruits of the contract even if the latter is perfectly able to do so without the client’s support.

A third issue involves the need to state a rule that can now be found in subparagraph (1)(d) of the Article, imposing an obligation on the service provider to enable the client to follow and check the service process. One might argue that such an obligation is not required, given that – as in any contract – it is the service provider’s sole responsibility to achieve the result required. On the other hand, notwithstanding that the client will have remedies if the result is not achieved, it would be in the client’s interest to be able to check the service on a regular basis whilst it is still being carried out. First of all, it would enable the client to establish the extent to which further co-operation is to be supplied. Moreover, the client would be enabled to anticipate a possible breach of the service provider’s obligations and, if appropriate, to give directions. By the same token, such a prevention of failure to achieve the result required, or limitation of its consequences, would also be in the interest of the service provider.

A fourth and final issue relates to the remedial effect of the non-performance of the client’s obligation to co-operate in the context of a service contract. One might question whether the rules stated in paragraphs (2) and (3) are needed, given that the service provider may resort to any of the normal remedies under Book III, Chapter 3. On the other hand, it might be doubted whether it is practical to invoke any of these remedies in the event of non-performance of an obligation to co-operate under a service contract. Resort to a remedy would indeed serve the interests of a seller under a sales contract if a buyer were to refuse to take delivery of the things sold. However, if a service provider is hindered in performing the service agreed on, this will probably happen in the middle of performance which costs time and money and which cannot readily be abandoned. Moreover, the service provider will probably not want to walk away in practice, and would probably prefer a rule that would allow the service to be continued and compensation to be claimed for costs and delay incurred as a result of the client’s failure. In this way the service provider could earn the fruits of the contract without having to go to court. On the other hand, the client has an interest in not being tied to the service provider any longer if the client does not want to be.

C. Preferred option

It is thought to be practical to deal explicitly with the most important and typical aspects of the obligation to co-operate under a service contract both in paragraph (1) of the present Article and in related Articles of Chapters 3 to 8 of this Part. This enables commercial practice to determine how the general obligation to co-operate under III.–1:104 (Co-operation) is to be applied in the context of a service contract. Moreover, the client’s specific obligations to co-operate under a service contract are at the very heart of this Part, together with the service provider’s main obligations. The importance of their interrelationship is reflected in many of the Articles of the present Chapter.

As regards the ambit of the client’s obligation, there is common ground for adopting the principle of necessity in subparagraphs (1)(a), (b), and (c). That principle is recognised throughout the legal systems investigated. It should be noted also that under subparagraph (1)(a) the client need answer only ‘reasonable’ requests.

Illustration 8

A fashion designer is carrying out a design contract for an international fashion company. The designer is dependent on regular instructions from an employee of the company as to how to proceed. The fashion designer rings the employee in the middle of the night to receive further instructions. The instructions are necessary but not urgently necessary. These phone calls are unanswered. The client is not in breach of the obligation to co-operate merely by failing to answer such calls. The requests are not reasonable requests.

The service provider's obligation to enable the client to follow and check the performance of the service whilst it is carried out is stated in subparagraph (1)(d) for various reasons, some of which have been mentioned above. What is essential to many service contracts is that the service is performed on the basis of the client's specific needs and wishes and that the client has an interest in determining whether these particular wishes are being fulfilled. The client will not always be able to check this once the service has achieved a particular result. And even if this were possible, it would be a waste of money and time for both parties if the result achieved deviates from the result contracted for. If the latter can be prevented by allowing the client to check the service process regularly – which is already common for some service contracts – both parties will benefit. In the same way, the performance of this obligation will enable the client to exercise relevant rights and perform relevant obligations under later rules of this Part.

The rules stated in paragraphs (2) and (3) are needed in addition to the normal remedies to which the service provider can resort. The service provider's interests are better protected by those rules. There will be no need to take the unprofitable position of having to walk away from the contract and seek resort to court. The rules will allow the service provider to continue the service and to earn the fruits of the contract. The interests of the client are sufficiently protected because the client can always invoke the right to terminate the contractual relationship under IV.C-2:111.(Client's right to terminate). That Article is in fact a direct expression of the client's right to cease co-operation.

D. Remedies

If a party fails to perform the obligation to co-operate, the normal remedies for non-performance of an obligation are available. Nothing more needs to be said regarding a non-performance by the service provider. However, some observations can be made as regards the client's failure to co-operate under the present Article.

If the client does not supply any co-operation *at all* this will usually prevent the service provider from performing the main obligations under the contract and for that reason the service provider may raise the defence of III.-3:101 (Remedies available) paragraph (3) (namely that the client caused the non-performance) against any claims put forward by the client. This is, for instance, what the dentist may do in the following example:

Illustration 9

Although a patient has agreed with a dentist to undergo treatment on a particular afternoon, he physically refuses to be treated once he is lying in the dentist's chair.

In addition, in such examples – when the client's failure to co-operate is not excused – all the normal remedies for non-performance of an obligation are in principle open to the service provider. However, in the context of a service contract there may be occasions where a claim for a specific performance of the client's obligation to co-operate will be excluded. For example, a dentist could not get an order compelling a patient to submit to treatment.

If the client fails to perform the obligation to co-operate in the first instance, but resumes co-operation later on, much of what has been said above on remedies will still be applicable. In practice, however, the service provider will probably not want to resort to a remedy under Book III, Chapter 3 but will instead try to claim extra payment and extension of time under paragraph (3) of the present Article.

It is also possible that the client performs the obligation to co-operate in a *defective* manner. The client may, for instance, supply incorrect or inconsistent information, which leads the service provider in the wrong direction and may have several consequences: (1) the result envisaged by the client at the time of conclusion of the contract may not be achieved; (2) other interests of the client may be damaged, or (3) the service may become more expensive or may take more time than agreed on in the contract.

Illustration 10

A supplier of computer networks is requested by the management of a hospital to install a tailor-made network on the basis of a design made on behalf of the hospital. The design, however, is defective. If the supplier were to follow the design exactly, the computer network would not serve the intended purposes.

If it is assumed that the service provider was not in breach of an obligation to warn (on which, see above), this example is to be resolved as follows. In situations (1) and (2), the client is not in a position to resort to any of the remedies under Book III, Chapter 3 because the client caused the non-performance. In situation (3), the client's defective co-operation gives the service provider the right to resort to any of the remedies set out in Book III, Chapter 3, provided the non-performance of the client's obligation is not excused. But again, it would probably be more practical for the service provider to claim extra payment and extension of time under paragraph (3) of the present Article.

IV.C.–2:104: Subcontractors, tools and materials

(1) The service provider may subcontract the performance of the service in whole or in part without the client's consent, unless personal performance is required by the contract.

(2) Any subcontractor so engaged by the service provider must be of adequate competence.

(3) The service provider must ensure that any tools and materials used for the performance of the service are in conformity with the contract and the applicable statutory rules, and fit to achieve the particular purpose for which they are to be used.

(4) In so far as subcontractors are nominated by the client or tools and materials are provided by the client, the responsibility of the service provider is governed by IV.C.–2:107 (Directions of the client) and IV.C.–2:108 (Contractual obligation of the service provider to warn).

COMMENTS

A. General idea

The supply of a service can be described as a process by which the service provider performs work undertaken according to the particular wishes and needs of the client, in order to achieve a particular result. The work undertaken requires in any event the supply of labour and could also involve the input of tools, materials, and components. This Article imposes obligations on the service provider with respect to the service process itself, particularly as regards the selection of tools, materials, and components to be supplied under the service contract. It further states rules in the event that subcontractors are involved in carrying out the service. Paragraph (2) is to be read in connection with IV.C.–2:105 (Obligation of skill and care). The obligation under this paragraph is to be performed with the care and skill required under that Article. Paragraph (3), however imposes strict obligations on the service provider, which cannot be performed by merely acting with care and skill.

Paragraph (1) allows as a principle the service provider to subcontract obligations under the service contract, either in part or in whole. This may be done without the client's consent, unless personal performance is actually required by the contract. Whether or not personal performance is required depends on the circumstances of the case and is left to the court to determine. In the following illustration an example is given of a case where personal performance would be required.

Illustration 1

A fashion company enters into a contract with a famous fashion photographer. The company instructs the photographer to make photographs of the latest fashion line of the company for the purpose of illustrating their catalogue. The photographer decides to shoot the indoor pictures himself but to subcontract the outdoor shooting to another professional photographer.

The obligation imposed on the service provider by paragraph (2) implies that any subcontractors selected should be capable of performing the service or part thereof subcontracted. The fact that the service provider subcontracted part of the service does not relieve the service provider from obligations under the contract, subject to the rule of paragraph (4), as follows from III.–2:106 (Performance entrusted to another).

Paragraph (3) imposes obligations on the service provider regarding the quality of the tools, materials, and other components to be used in the course of the service. There is a strict obligation to select tools, materials, and other components of such quality as is needed to ensure that the result the client wishes to obtain through the service will actually be achieved.

The service is to be performed on the basis of the wishes and needs specified by the client. The client may want the service or part of it to be performed by specific subcontractors, in which case the client will nominate them to the service provider.

Illustration 2

The Ministry of the Interior awards a contract for the investigation of corruption practices in the civil service to a specialised consulting agency. The Ministry insists that part of the investigation – the analysis of the credibility of existing internal reports dealing with the subject matter – is to be carried out by a specialised research institute.

The client may further wish that the service be carried out with the help of tools, materials, and other components to be supplied by the client.

Illustration 3

A house owner agrees with a painter that the latter will paint all the doors of the house with special paint bought by the owner of the house.

If the service is carried out by nominated subcontractors or with the help of tools, materials, and components supplied by the client, it may happen that the result the client envisages will not be achieved. In that case, the service provider's liability is to be established under paragraph (4) in conjunction with the rules in IV.C.–2:107 (Directions of the client) paragraph 2, given that both the nomination of a subcontractor as well as the actual supply of tools, materials, or other components by the client are thought to be equal to the issuing of a direction by the client. The Article on directions by the client also provides rules for the situation where the client directs the service provider to use inadequate tools, materials, or other components – i.e. selected, though not actually supplied by the client himself – whether or not to be obtained by the service provider from a nominated subcontractor.

The contract may oblige the service provider to transfer the ownership of what is produced. To the extent that ownership is to be transferred for a price or in exchange for something else the contract would be one of sale or barter and the obligations of the parties would be regulated by Book IV.A. The provisions of that Book would regulate such matters as conformity of the things with the contract and freedom from third party rights or claims.

Illustration 4

A client enters into a contract with a computer shop. The purpose of the contract is to change the mainframe of the client's personal computer and to install on that computer the latest version of a well-known anti-virus software program.

In such cases, interpretation of the contract will lead to the conclusion that the parties have impliedly agreed on transfer of ownership of the structure or thing produced as a result of the service. The same goes for the supply of materials, components, and all other things – corporeal or incorporeal – inherent to the service. There is a mixed contract – partly for the supply of a service and partly for the sale of goods or other assets. In accordance with II.–1:108 (Mixed contracts) the rules of this Part apply to the service component. The rules on sale apply to the obligations of the parties under the sale component. The rules governing the actual transfer of ownership of movable things can be found in the Book on the transfer of moveable goods and in national rules on the transfer of immovable property.

B. Interests at stake and policy considerations

The main issue is whether explicit rules are needed stating obligations which are self-evidently imposed on a service provider and which might also be derived from the main obligation under the contract. In addition, it is difficult to see what remedies the client may resort to if the service provider fails to perform these obligations. Such a failure will probably coincide with a failure of the service provider to achieve the result envisaged by the client, in which case the latter would rather invoke a remedy on the basis of the non-performance of the service provider's main obligation stated in IV.C.–2:106 (Obligation to achieve result). On the other hand, that obligation (to achieve the result) will not always be imposed on every service provider in every case. This would imply that the obligations under the present Article may still be useful in order to enable the client to resort to a remedy.

It could further be argued that it is useful to regulate the quality of the input into the service process because it gives the service provider incentives to prevent the result envisaged by the client from not being achieved. It would stimulate the service provider to select competent subcontractors and to use adequate tools, materials, and components.

Rules dealing with the quality of the service provider's input into the service process would also make it easier for the client to take precautionary actions. It is typical for a service contract that the client is able to check and follow the service process whilst it proceeds. The present Chapter contains various provisions to support this ability. Such an

interaction may lead to the client's discovery that the service provider failed to select competent subcontractors, or failed to select adequate tools, materials, or components. This may even disclose the risk that the result envisaged by the client will not be achieved. Rules imposing an obligation on the service provider as regards the quality of the input into the service process would then enable the client to anticipate the breach of the latter's main obligation by taking precautionary actions. The client might notify the service provider or give a direction. The client might also demand an adequate assurance of due performance under III.-3:505 (Termination for inadequate assurance of performance). This would be advantageous for both parties as disputes about quality will be solved as early as possible in the process and not at the final stage, when it probably will be much more costly to accomplish changes.

C. Preferred option

The ability of a service provider to achieve the result envisaged by the client often depends on the ability to select competent subcontractors and to use tools, materials, and components of good quality and fit for their purpose. If, subsequently, the desired result is not achieved because the service provider failed to select such subcontractors, tools, materials, or components, the client will not always be able to resort to a remedy on the basis of the allegation that the service provider failed to perform the obligation under IV.C.-2:106 (Obligation to achieve result). The reason is that this obligation is not imposed on every service provider in every case. If it is not, the client will have to invoke non-performance of another obligation in order to be able to resort to a remedy. This may be one of the obligations imposed on the service provider by in the present Article.

Illustration 5

The owner of a seventeenth century painting, which has been exposed to smoke and other damaging conditions for centuries, concludes a contract with a specialist restorer under which the restorer is obliged to try to bring back the original colours of the painting without damaging it. The restorer uses a steel brush that is too stiff to do the job and subsequently damages the painting.

In this example, the client will not be able to claim on the basis of failure to achieve a result because the obligation is only to attempt restoration. However, the client will be able to claim on the basis of paragraph (3) of the present Article.

Furthermore, by making the obligations explicit – as is done in the present Article – the service provider is stimulated to achieve the result envisaged by the client. This will particularly be the case if the latter can anticipate the failure to achieve such a result – which is inherent in the ability to check and follow the service process as it proceeds – by invoking the failure to select either, competent subcontractors or adequate tools, materials, and components.

Particular problems may arise when the client has instructed the service provider to use particular tools, materials, and components – whether or not to be obtained from a nominated subcontractor – that turn out to be inadequate.

Illustration 6

A storer has agreed with a client to store liquid nitrogen. The storer is instructed to use a particular machine for keeping the nitrogen at the right temperature. This machine, however, turns out to be defective and as a result the nitrogen can no longer be used for certain industrial purposes.

This issue is dealt with in the Articles on directions by the client and the service provider's contractual obligation to warn.

D. Remedies

If the service provider is obliged to achieve a particular result and fails to do so because of non-performance of one or more of the obligations imposed by this article, it is in the client's interest to invoke non-performance of the service provider's main obligation. The burden of proof on the client will then be limited. In this scenario, it is not likely that the client will invoke non-performance of an obligation under the present Article as this would mean a heavier burden of proof. An example of a case where the client will most likely claim on the basis of non-performance of the main obligation is given in the following Illustration.

Illustration 7

A garage manager agreed with a car owner to replace the exhaust pipe of the latter's car. The materials used by the mechanic to connect and attach the exhaust pipe to the car are not strong enough. As a result, the pipe comes down after a few days.

Moreover, a claim that would in effect seek double compensation for the same damages would in any event be barred.

An obligation to achieve a result will, however, not be imposed on every service provider in every situation. If it is not imposed, the client may be led to invoke non-performance of an obligation of the service provider under the present Article.

IV.C.-2:105: Obligation of skill and care

(1) The service provider must perform the service:

- (a) with the care and skill which a reasonable service provider would exercise under the circumstances; and*
- (b) in conformity with any statutory or other binding legal rules which are applicable to the service.*

(2) If the service provider professes a higher standard of care and skill the provider must exercise that care and skill.

(3) If the service provider is, or purports to be, a member of a group of professional service providers for which standards have been set by a relevant authority or by that group itself, the service provider must exercise the care and skill expressed in those standards.

(4) In determining the care and skill the client is entitled to expect, regard is to be had, among other things, to:

(a) the nature, the magnitude, the frequency and the foreseeability of the risks involved in the performance of the service for the client;

(b) if damage has occurred, the costs of any precautions which would have prevented that damage or similar damage from occurring;

(c) whether the service provider is a business; ;

(d) whether a price is payable and, if one is payable, its amount; and

(e) the time reasonably available for the performance of the service.

(5) The obligations under this Article require in particular the service provider to take reasonable precautions in order to prevent the occurrence of damage as a consequence of the performance of the service.

COMMENTS

A. General idea

Supplying a service is in fact equivalent to a process during which a service provider takes all kinds of decisions for the purpose of achieving a specific result, stated or envisaged by a client. These decisions involve the carrying out of labour which is – with the exception of pure intellectual services – usually carried out by the application of materials and components by means of tools. The service provider's strict obligations as regards the *selection* of these tools, materials, and components, are all dealt with in the preceding Article. That Article further states rules as regards the selection of subcontractors. The present Article imposes obligations on the service provider with respect to the carrying out of the service process itself. These obligations relate to the decisions the service provider must take as regards the *application* of the tools, materials, and components, in the course of the labour process.

The central obligations imposed on the service provider by paragraph (1) presuppose that, whenever carrying out a service, the service provider will first of all have to observe the requirements to be found in the contract itself. In addition, there may be statutory requirements or other binding provisions which have to be followed.

Illustration 1

A company specialised in removing asbestos isolation material, agrees with the owner of an old factory to clean that factory from asbestos. The company will have to observe all legal provisions related to health and safety at work whilst carrying out the said contract.

Paragraph (1)(a) imposes an obligation on the service provider to carry out the service with the care and skill generally to be observed in the circumstances of the case. In doing so, the intention of the service provider must be to achieve the result stated or envisaged by the client. Whether an *obligation* to achieve that result is to be imposed on the service provider, depends on the interpretation of the contract, taking into account IV.C.–2:106 (Obligation to achieve result). The present Article merely imposes an obligation on the service provider to make every reasonable effort for the achievement of the particular result.

Illustration 2

A doctor agrees to treat a patient suffering from severe pneumonia. The intention of the doctor is to cure the patient and he will have to do his best to achieve that result. But he cannot guarantee that the treatment will indeed cure the patient.

An important aspect of the obligation under the present Article will often be careful collection of information about circumstances in which the service is to be performed, adequate planning of the performance in the light of those circumstances and the taking of care to ensure that they are taken into account while the service is being performed.

Illustration 3

An oil production plant hired a specialised contractor to repair pipes that were damaged due to regular pressure. Before starting the actual repair work, the contractor will not only have to establish the way in which other parts of the installation influence the functioning of the pipes, but will also have to find out how the functioning of the pipes affects the functioning of other parts of the installation.

Illustration 4

A management consultant agreed to investigate the logistics department of a large food production factory and to advise on a possible reorganisation of the department. Once the contract is concluded, the consultant can be expected to gather information as regards the ages, education, job descriptions and career developments of the employees working at the department; and about the internal and external work processes that take place at the logistics department.

Illustration 5

A farmer contracts the harvesting of a maize crop out to a company that specialises in providing labourers and machinery for that purpose. The company will have to establish whether the soil can support tractors despite the recent heavy rainfall.

Illustration 6

A geo-technical surveyor is requested to investigate the subsoil conditions of a particular piece of land and to advise on the necessity of extra foundation works, for the purpose of a building that is to be erected on that piece of land. The

surveyor fails to take into account the geo-technical influence of a nearby tidal river and gives the client the wrong advice.

The standard of care to be demonstrated by the service provider depends on the circumstances of the case. The Article, however, further specifies the required standard of care for some important and frequently occurring situations. Paragraph (2) deals with the situation in which the service provider professes to be capable of performing the service with a higher standard of care and skill than the standard generally required. If that is the case, the higher standard is the one to be observed, as is shown in the following illustration:

Illustration 7

A law firm specialises in giving legal advice on proposed mergers and takeovers. It is the firm's only field of business. The firm has a high reputation among other law firms and must live up to that reputation.

If the service provider is a member of a group of professional service providers which has set its own disciplinary standards to be observed, paragraph (3) requires that these standards will also have to be observed by the service provider. Such standards will usually have been set by a relevant authority – usually a national authority – which can either be a public authority or a private entity.

Illustration 8

A contract is concluded between a client and a shop which specialises in body piercing. The shop will have to observe the disciplinary standards set out by the National Association of Body Decoration.

Finally, the criteria provided for in paragraph (4) are to be taken into account in determining the standard of care and skill to be demonstrated by the service provider. They are not to be regarded as the only criteria that have to be looked at, but they are thought to be the most relevant ones.

The obligations which this Article imposes on the service provider all relate to the particular result to be achieved through the service process. That result can be thought of as the accomplishment of the client's explicit and implicit wishes and needs. It is implied in these wishes and needs that the service process will – apart from the achievement of the said result – not lead to personal injury or damage to property.

Illustration 9

A storer agrees with a fireworks trader to store fireworks. The safety policy of the storer is not very strict: employees smoking cigarettes are able to walk past the open containers in which the fireworks are kept. As a result an explosion occurs and several residents living nearby are killed and several adjacent buildings and cars are seriously damaged.

Because of the importance of this point, paragraph (5) expressly requires reasonable precautions to be taken by the service provider to prevent the occurrence of damage as a consequence of the performance of the service. “Damage” means any type of detrimental effect: it includes loss and injury (Annex 1). In the case of construction and processing contracts a particular application of this rule is that the service provider must take reasonable precautions to prevent damage to the thing being made or processed.

B. Interests at stake and policy considerations

It is undisputed that an obligation should be imposed on the service provider to carry out the service with the care and skill generally to be observed in the circumstances of the case and that it must at least be the intention of the service provider to achieve a result stated or envisaged by the client. The crucial issue is whether the service provider has a further obligation to actually achieve that result through the service. That issue is considered in Comment B to the following Article.

A related issue is whether the service provider must still carry out the service with the required care and skill if there is an obligation to achieve a particular result. One might argue that failure to carry out the service with due care and skill will then probably coincide with a failure to achieve that result, in which case the client will invoke a remedy on the basis of the non-performance of that primary obligation. There would then be no need for a separate obligation to carry out the service with care and skill, given that it would be superfluous to allow the client to resort to a remedy for the non-performance of that obligation if the client could also claim for non-performance of the primary obligation.

It could be argued that it is useful to impose the obligation of care and skill on the service provider in any event, because that gives the service provider incentives to prevent the result from not being achieved. Imposing the obligation, even in the case where the service provider has an obligation to achieve a particular result, would also make it easier for the client to take precautionary actions. The client is in the position to do so, given that he can check and follow the service process as it proceeds, and discover problems at an early stage. Imposing the obligation of care and skill, even if the service provider is under an obligation to achieve a particular result, would then enable the client to anticipate the breach of that obligation. The client could give a direction or a notification and could demand an adequate assurance of due performance. Both parties will profit from these precautionary actions if they enable problems to be identified and disputes to be resolved at an early stage.

C. Preferred option

The present Article imposes an obligation on the service provider to carry out the service with the care and skill generally to be exercised by a reasonable service provider in the circumstances of the case. This is the fundamental obligation imposed on a service provider in all legal cultures, unless there is reason to impose the stricter obligation to actually achieve the result stated or envisaged by the client. The present Article is needed for cases where the latter obligation is not imposed on the service provider.

Even a service provider who is subject to the stricter obligation to achieve the required result will still be under an obligation to carry out the service with the required care and skill for the reasons explained above.

D. Remedies

It is possible that the service provider is not only under an obligation to carry out the service with due care and skill, but also under an obligation to achieve the result stated or envisaged by the client. If that is the case, and if the result is not achieved, it is in the client's interest to invoke the non-performance of the latter obligation. The burden of proof imposed on the client will then be limited.

The obligation to achieve a particular result will, however, not be imposed on every service provider in every situation. If it is not imposed, this might cause the client to invoke the non-performance of an obligation of the service provider under paragraphs (1) to (4) of the present Article. The client may resort to any of the remedies of Book III, Chapter 3 if the service provider fails to perform the obligation stated in paragraph (5) of the present Article. The most likely remedy will be damages.

IV.C.–2:106: Obligation to achieve result

(1) The supplier of a service must achieve the specific result stated or envisaged by the client at the time of the conclusion of the contract, provided that in the case of a result envisaged but not stated:

(a) the result envisaged was one which the client could reasonably be expected to have envisaged; and

(b) the client had no reason to believe that there was a substantial risk that the result would not be achieved by the service.

(2) In so far as ownership of anything is transferred to the client under the service contract, it must be transferred free from any right or claim of a third party. Articles IV.A.–2:305 (Third party rights or claims in general) and IV.A.–2:306 (Third party rights or claims based on industrial property or other intellectual property) apply with any appropriate adaptations.

COMMENTS

A. General idea

A client who concludes a service contract generally wants to obtain a particular result. The ability of a service provider to achieve that result, however, depends on a number of factors which will not always be under the control of the service provider. This can be illustrated by the following examples:

Illustration 1

A patient suffering from a severe form of cancer enters into a contract with a specialised doctor in order to be cured through medical treatment.

Illustration 2

A law firm is engaged by a victim of alleged medical malpractice for the purpose of obtaining financial damages from the doctor through legal action.

Whether a service provider has promised to achieve a particular result – for example to cure the patient from cancer, or to obtain damages in a lawsuit on his client’s behalf – is a matter of interpretation of the contract. The same goes for the question what that particular result to be achieved consists of. The purpose of the present Article is to assist the process of interpretation in those cases where the contract does not regulate the matter expressly.

The rule under the Article is that the service provider is under an obligation to achieve the particular result in the following two situations: (1) before conclusion of the contract, the client expressly requires the service provider to achieve the result, and the service provider does not dispute that the service will be able to achieve that particular result, and (2) at the time the contract was concluded, the parties did not expressly discuss the matter, but a reasonable service provider would expect the client to expect the result to be achieved.

If the client states the particular result, it will already be clear to the service provider what it is that the client expects. If the result is not stated, the particular result *envisaged* by the client must be determined. In that case the result to be achieved is the result that is in the mind of the objective, average reasonable client. Clearly, an average competent service provider must know what is in the mind of such a client.

Illustration 3

A motorcycle is brought to a garage for the purpose of changing the tyres. If the type of tyres to be supplied is not specified, the average reasonable client may expect new tyres of the same type as the old ones. The client may not expect the motorcycle to be fit for off road journeys, if it is objectively clear from the type of motorcycle and from the type of tyres to be changed that such journeys were not possible prior to changing the tyres.

If it is clear what the particular result is that is to be achieved, application of the Article still depends on the client’s having no reason to believe that there was a substantial risk that the result would not be achieved by the service. Obviously, the parties to the contract may have differing views. An average and reasonable client may very well believe that the service will lead to the envisaged result without any risk, whereas the average competent service provider in the same situation may not always have that belief, as is illustrated in the following example:

Illustration 4

A supplier of computer networks is asked by a hospital to install a tailor-made network, following a design prepared on behalf of the hospital. The hospital sincerely believes that the design is perfect, but it is not. If the supplier were to follow the design exactly, the hospital would not be able to use the computer network for the purposes it has in mind. The supplier does not trust the design handed over by the client.

If the parties have differing views on whether the result can be achieved without any risk, the Article nevertheless applies and the obligation to achieve the particular result is imposed on the service provider. If the average competent service provider would expect the achievement of the result to be endangered by the occurrence of some substantial risk, he must warn the client about that risk (see IV.C.–2:102 (Pre-contractual duties to warn) and 2:108 (Contractual obligation of the service provider to warn)). Once so warned, a reasonable client could no longer have the belief that there is no substantial risk that the result will not be achieved by the service.

A reasonable client may expect a constructor, a designer, a storer, as well as a supplier of factual information to achieve the particular result through the performance of the service requested. That is the reason why the obligation to achieve such a result is imposed upon these service providers in principle by the later Chapters in this Part. The obligation is not imposed as a principle on a processor, a supplier of evaluative information or a provider of medical treatment. Dependent on the circumstances of the case, however, interpretation of the contract on the basis of the rules of the present Article could lead to the conclusion that these service providers too are under an obligation to achieve the particular result envisaged by the client. This is clearly the case in the example given in the following illustration:

Illustration 5

A garage is asked by a car owner to remove and change the standard exhaust pipe of a standard car.

Finally, whenever a contract is interpreted in the sense that the service provider must achieve a particular result, other Articles imposing obligations – either under the present Chapter, or under the relevant specific Chapter of this Part – nonetheless remain applicable.

Paragraph (2) deals with a particular application of the general rule in paragraph (1). Where the ownership of something is transferred to the client under, or as a result of, the service contract, the client can reasonably expect that such ownership will be free from any right or claim of a third party. Sometimes this result will be achieved through the direct application of the rules on sale. This will be the case if, for example, the contract is one for construction and sale (see II.–1:108 (Mixed contracts) and IV.A.–1:102 (Goods to be manufactured or produced)) or if it is categorised as a mixed contract for sale and the performance of a service (for example, selling and fitting a car tyre). Paragraph (2) of the

present Article extends the sale solution to cases where the ownership is transferred without there being, technically, a sale. For example, a fitted part may become the property of the client by accession under the rules on the transfer of property.

B. Interests at stake and policy considerations

The question addressed by this Article is probably the most important issue in the context of service contracts. Two different approaches are generally recognised.

The first approach is to establish the service provider's liability on the basis of failure to perform the service with the required care and skill. In this approach, the idea is that the obligation imposed upon the service provider is an obligation of means, implying that the provider must strive for the achievement of the result envisaged by the client. In the event that such result is not achieved, the client must prove that the service provider failed to perform the service with due care and skill. Conversely, the service provider is allowed to prevent liability by proving that the service was performed with due care and skill.

The second approach is to establish the liability of the service provider on the basis of the mere fact that the service did not achieve the result stated or envisaged by the client at the time of conclusion of the contract. In this approach, the idea is that the obligation imposed upon the service provider is an obligation of result, implying that it is not enough merely to attempt to achieve the required result. If the result is not achieved, the client has to establish that fact. The service provider may escape liability by proving that the non-performance of the obligation was caused by the client or excused by an impediment but cannot prevent liability by proving that the service was performed with due care and skill.

It is difficult to make a choice between the two approaches for all types of service contracts. The client's interests are obviously protected best by the second approach. But the difficulty is that, although it may be appropriate to impose an obligation of result on most service providers, it would be harsh to impose such an obligation on some of them, given their inability to fully control the outcome of the service process, even if they make every effort to achieve the result envisaged by the client. Imposing an obligation of result on such service providers would not only be a danger to their interests, but would also make their services much more expensive for the client, given that the service provider would have to buy insurance for the coverage of uncontrollable risks. Where insurance cover cannot be obtained or can be obtained only at very high costs, this might cause service providers to withdraw from the market, leading to the disappearance of such services altogether.

C. Preferred option

The solution which is chosen in this Article reflects the idea that the probability that the result envisaged by the client can be achieved should be decisive for the obligation to be imposed upon the service provider. This means that neither the first nor the second approach sketched out under Comment B has been adopted for all services contracts. It is preferred to have a more flexible solution, which makes it possible to take into account

the particularities of each type of service. Hence, if it is probable that the service can achieve the required result, an obligation to do so is imposed on the service provider (in the absence of a contractual provision to the contrary). If there is no such probability, the obligation is not imposed. Liability will then have to be established on the basis of the rules under the other Articles of this Chapter, in particular under the preceding Article .

In order to establish in each particular case whether it is probable in advance that the result envisaged by the client can indeed be achieved, it is necessary to determine whether the service provider ought to be able to identify and control the following three important factors – as well as the interrelationship that exists between them – in order to achieve that result: (1) the (particular) needs of the client, (2) the services provider’s (tailor-made) solution that fits these needs, and (3) the circumstances in which the service is to be performed. In some services dealt with later in this Part, the service provider is deemed to have this ability. An obligation to achieve the particular result is imposed upon these service providers as a principle.

D. Remedies

If the service provider is under an obligation to achieve the result stated or envisaged by the client and fails to achieve that result, the client may resort to any of the remedies set out in Book III, Chapter 3, provided that the non-performance is not excused under III.–3:104 (Excuse due to an impediment) and that the client complies with any requirements as to notification - e.g. under III.–3:107 (Failure to notify for non-conformity).

It is possible that the service provider is prevented from achieving the result by the client’s failure to warn under IV.C.–2:102 (Pre-contractual duties to warn) paragraph (4) or failure to co-operate under IV.C.–2:103 (Obligation to co-operate) (1)(a), (b), (c) or (e), or as a result of following a direction of the client under IV.C.–2:107 (Direction of the client) paragraph (1). This would give the service provider a defence under III.–3:101 (Remedies available) paragraph (3) on the ground that the client had caused the non-performance. However, if the service provider was under a duty to warn the client that the result might not be achieved due to the client’s incorrect or inconsistent information or directions, and failed to perform that duty, the issue becomes different. In that case the client’s information or directions are no longer to be regarded as the only cause of the fact that the service provider has not achieved the result. The service provider will then not be able to bar the client’s claim on the basis of III.–3:101(Remedies available) paragraph (3) or prove that the non-performance was due to an impediment beyond the service provider’s control. The client may then in principle resort to any of the normal remedies.

Failure by the client to warn of an *anticipated* failure to achieve the required result under IV.C.–2:110 (Client’s obligation to notify anticipated non-conformity) will not bar the client’s claim for non-performance of the obligation under the present Article, because the failure to notify did not cause the service provider’s non-performance. The client may then too resort to any of the normal remedies: failure by the client to notify of an

anticipated non-performance gives the service provider certain rights but does not cut off the client's remedies.

IV.C.-2:107: Directions of the client

(1) The service provider must follow all timely directions of the client regarding the performance of the service, provided that the directions:

(a) are part of the contract itself or are specified in any document to which the contract refers; or

(b) result from the realisation of choices left to the client by the contract; or

(c) result from the realisation of choices initially left open by the parties.

(2) If non-performance of one or more of the obligations of the service provider under IV.C.-2:105 (Obligation of skill and care) or IV.C.-2:106 (Obligation to achieve result) is the consequence of following a direction which the service provider is obliged to follow under paragraph (1), the service provider is not liable under those Articles, provided that the client was duly warned under IV.C.-2:108 (Contractual obligation of the service provider to warn).

(3) If the service provider perceives a direction falling under paragraph (1) to be a variation of the contract under IV.C.-2:109 (Unilateral variation of the service contract) the service provider must warn the client accordingly. Unless the client then revokes the direction without undue delay, the service provider must follow the direction and the direction is deemed to be a variation of the contract.

COMMENTS

A. General idea

The client will generally translate wishes and needs into directions to be observed by the service provider when carrying out the service. These directions could involve the nomination of subcontractors, the selection of specified tools, materials, and components and the manner in which the service is to be performed, including the application of the tools, materials, and components through labour. They might contain functional requirements, specifying the outcome that will eventually have to result from the service process.

Illustration 1

A building constructor agrees to build a new office for an investment bank. The constructor receives instructions from the client to cover the walls of the meeting room of the bank's board of directors with 18 mm wooden panels (meranti), to be obtained from supplier X and to be fixed by means of contact glue of type Y by subcontractor Z.

Such directions will usually be laid down in the contract itself, or in the documents and drawings the contract refers to. Paragraph (1)(a) imposes an obligation on the service

provider to follow these directions. It is also possible that the contract allows the client to issue such a binding direction at a later stage under paragraph (1)(b), by making a choice left to the client by the contract, or under paragraph (1)(c), following a choice that may be made by either party at a later stage (c).

Paragraph (1) further requires directions to be given reasonably and in good time. Whether a direction is so given depends on the circumstances of the case. The steps that have already been taken by the service provider for the purpose of performing the obligations under the contract will have to be taken into account.

If the service is carried out following the client's directions, it may happen that the result the client intends will eventually not be achieved. In that case the service provider's liability is to be established under paragraph (2) of the present Article, which follows the same principle underlying various other provisions of this Chapter dealing with similar forms of defective co-operation of the client. That principle accepts the liability of the client for defective co-operation in principle, subject to the exception of the service provider's failure to warn. An example of a case where a service provider failed to warn in this respect, is to be found in the following illustration:

Illustration 2

A supplier of computer networks is asked by a hospital to install a tailor-made network, following a design prepared on behalf of the hospital. The network as designed is fit for the purpose the hospital has in mind, namely to allow a maximum of 150 staff members to use the network at the same time. Whilst the installation service is carried out, the hospital instructs the supplier to make 250 workplaces throughout the hospital available for entering the network, without instructing the supplier to enlarge the access capacity of the network. When the network is completed, it shuts down 15 times a day due to an overload of simultaneous access attempts.

Some directions are refinements of choices already made in agreement between the parties.

Illustration 3

A garage agrees to paint the car of a customer yellow for a fixed price. Once the contract is concluded and the service is to be performed, the customer chooses from a range of colours the exact type of yellow.

A client who wishes to leave the framework of such choices is allowed to do so. But in that case, the rules on variation of the contract will apply, according to paragraph (3). This can be explained on the basis of a modification of Illustration 3.

Illustration 4

A garage agrees to paint the car of a customer yellow for a fixed price. When the car is being painted, the customer instructs the garage to paint a black horizontal banner on both sides of the car.

Given that there is often an imprecise borderline between a direction that is issued within the boundaries of the existing contractual framework on the one hand, and a direction, which is outside that framework on the other, the service provider has to warn the client if of the view that this borderline is crossed.

B. Interests at stake and policy considerations

One issue is whether a client ought to be allowed to give directions while the service process is already on its way. It could be argued that it is essential for the client to be able to do so. In some situations it will be impossible or impracticable to foresee every detail of both the service process and the result that is to be achieved through that process at the conclusion of the contract. Often it is much easier to take decisions about such details when the process is already on its way and the contours of the result are visibly present. Also, if it becomes clear that achievement of the result becomes a problem due to unexpected developments, which cannot be controlled by the service provider, the client will most likely want to be able to decide how the latter is to proceed with the service. Hence the client can contribute – by way of giving directions – to the achievement of a successful result.

But the downside of this is that directions may run contrary to the expectations of the service provider, who will have organised the work in accordance with the directions laid down in the contract itself and a reasonable interpretation of what is needed to accomplish the agreed outcome through the service. Directions may conflict with measures taken by the service provider, or even with the way parts of the result of the service have already been achieved.

Another issue involves the responsibility for any unfortunate consequences resulting from carrying out a direction. If the service provider observes a direction, which is incorrect or inconsistent with previous directions having regard to the result envisaged by the client, it is likely that the provider will not achieve that result. This means that directions might conflict with the obligations of the service provider under other Articles of this Chapter, and especially with the obligation to achieve the result which is imposed on some service providers. One might argue, as a general principle, that the client should presumably be responsible for the consequences of his directions to the service provider. In following these directions, the latter does nothing but perform the agreed obligations. But on the other hand, the service provider is in a much better position to assess the consequences of the directions given by the client. It is the provider who carries out the service, and who will usually have much more technical and other professional knowledge than the client. Channelling some of the responsibility to the service provider would therefore seem to be reasonable as well.

C. Preferred option

The present Article allows the client to give directions to the service provider in the course of the service process. The arguments set out in Comment B support this choice.

If a direction would lead to a change of the service, the service provider will have to notify the client of that, in order to trigger the operation of the rules under IV.C.–2:109 (Unilateral variation of the service contract) which might allow additional payment.

If the result of following an incorrect or inconsistent direction is that the service provider does not achieve the result envisaged by the client or otherwise fails to perform an obligation under the contract, the client may seek a remedy for the non-performance of the service provider's obligation. The service provider is then allowed to establish that the non-performance was caused by the incorrectness or inconsistency of the client's direction. The service provider will not be allowed to invoke the client's responsibility if the incorrectness or inconsistency of the direction was obvious to the provider or was actually discovered by the provider.

Mere selection by the client – through a direction – of generally adequate tools, materials, and components – whether or not to be obtained from a nominated subcontractor – which turn out to be unfit for their purpose in the particular case concerned due to an incidental production failure is not to be regarded as a direction which caused non-performance of the service provider's obligations. This can be explained by giving an illustration that is a further modification of Illustrations 3 and 4.

Illustration 5

A garage agrees to paint the car of a customer yellow for a fixed price. The customer specifies the type and colour of the car paint to be supplied by the garage. This type of paint is generally suitable for painting cars. However, due to an incidental production failure, the garage buys a can of paint, which does not do the job properly.

The main reason why the client's specification cannot be considered to have caused the non-performance follows from the general idea that decisions of the client in these typical situations do not restrict the freedom of the service provider to select *adequate* tools, materials, or components. Moreover, the service provider will have remedies against the supplier. An exception to this principle could arise in the event that the input – unfit due to an incidental production failure – is to be obtained from a nominated subcontractor who then limits liability towards the service provider to a further extent than the limitation the latter can resort to under the contract with the client. The exception will particularly be needed if the service contract does not allow the service provider to object to the nomination.

IV.C.-2:108: Contractual obligation of the service provider to warn

(1) The service provider must warn the client if the service provider becomes aware of a risk that the service requested:

(a) may not achieve the result stated or envisaged by the client at the time of conclusion of the contract;

(b) may damage other interests of the client; or

(c) may become more expensive or take more time than agreed on in the contract either as a result of following information or directions given by the client or collected in preparation for performance, or as a result of the occurrence of any other risk.

(2) The service provider must take reasonable measures to ensure that the client understands the content of the warning.

(3) The obligation to warn in paragraph (1) does not apply if the client:

(a) already knows of the risks referred to in paragraph (1); or

(b) could reasonably be expected to know of them.

(4) If a risk referred to in paragraph (1) materialises and the service provider did not perform the obligation to warn the client of it, a notice of variation by the service provider under IV.C.-2:109 (Unilateral variation of the service contract) based on the materialisation of that risk is without effect.

(5) For the purpose of paragraph (1), the service provider is presumed to be aware of the risks mentioned if they should be obvious from all the facts and circumstances known to the service provider without investigation.

(6) For the purpose of paragraph (3)(b), the client cannot reasonably be expected to know of a risk merely because the client was competent, or was advised by others who were competent, in the relevant field, unless such other person acted as the agent of the client, in which case II.-1:105 (Imputed knowledge etc.) applies.

COMMENTS

A. General idea

This Article imposes a contractual obligation to warn on the service provider which is very similar to the duty under IV.C.-2:102 (Pre-contractual duties to warn). The obligation is supplemented by the obligation in paragraph (2) to take reasonable measures to ensure that the client understands the content of the warning. A warning in writing is generally not required. Which measures are adequate depends on the circumstances of the case.

Again, the obligation to warn relates to typical risks which might occur in the course of the service and which would go to the very heart of the contract. The risks are identified in paragraph (1). The service provider will only have to warn on becoming aware of the risks but will not be under an obligation to warn if the client already knows of the risks or could reasonably be expected to know of them. That principle is reflected in paragraph (3) in conjunction with (5) and (6). Under paragraph (5) the service provider is presumed

to be aware of the risks mentioned if they should be obvious from all the facts and circumstances known to the service provider without investigation.

The obligation under the present Article differs from the pre-contractual duty to warn. The extent of the pre-contractual duty to warn is dependent on risks that are obvious or actually discovered by the service provider, given the information the service provider ought to have collected in order to make an informed offer to the client as regards the service that can be supplied. The information to be collected by the service provider particularly relates to the relevant wishes and needs of the client, as well as to important circumstances in which the service is to be performed. It may very well be the case that such information – *prior to* the conclusion of the contract – will not give rise to a duty to warn under IV.C.–2:102 (Pre-contractual duties to warn) paragraph (1). The reason for that may be that the risks are neither obvious nor discovered in the process of preparing an offer for the required service. But they may subsequently become obvious or may even be actually discovered *after* the conclusion of the contract, for two reasons.

One reason could be that the service provider will now have to look at the information, supplied before the conclusion of the contract, from a different perspective. That perspective is no longer the preparation of an offer, but the actual carrying out of the service in order to achieve the result envisaged by the client. Risks that were previously undetected, could now become obvious, particularly if the service provider collects additional information as part of the performance of the service. Another reason could be that the client has supplied additional information, directions, permits or licenses after the conclusion of the contract. If the service provider analyses these additional data in the context of the information previously supplied, the risks might become obvious or might be actually discovered.

Having regard to the purpose of the analysis of the information and directions sketched out above, the service provider is not bound to actually check whether observing the information or directions might give rise to one or more of the risks referred to in paragraph (1) but should be normally attentive given the purpose of the analysis. That principle is reflected in paragraph (5).

If the service provider does not perform the obligations under paragraphs (1) and (2) leading to the occurrence of one of the risks mentioned in paragraph (1)(a) or (b), the client may resort to the normal remedies under Book III, Chapter 3. In addition to the client's right to resort to these remedies, paragraph (4) of the present Article contains a further rule protecting the client, in the event that the failure to warn results in the risk mentioned in paragraph (1)(c). That rule is particularly relevant if payment of either a fixed price or a fee based on a no result, no pay-basis was agreed at the time of conclusion of the contract. It prevents the service provider from claiming compensation for the extra cost incurred, as well as an extension of time, under the following Article.

B. Interests at stake and policy considerations

The main issue is whether an obligation to warn is to be imposed on a service provider at all. It could be argued that the service provider should only have to act in conformity with the client's wishes and specifications stated at the time of conclusion of the contract, and with other directions supplied by the client. The argument would be that the service provider should respect the wishes of the client and live up to freely assumed contractual obligations. On the other hand, it could be argued that the service provider is in a much better position than the client to discover mistakes in the client's directions. Before carrying out the service, the provider will normally have to analyse the client's wishes in order to determine what exactly has to be done. The same will go for directions issued later on. In doing so, the provider might discover all sorts of gaps, ambiguities, inconsistencies, and mistakes which might cause problems if they were followed without clarification or correction in advance. Warning the client in such situations will hardly impose extra costs on the service provider. It may even be beneficial, given that it would prevent future disputes.

This leads to a second issue. What should trigger the obligation to warn, having regard to the content of the information and directions either supplied by the client or collected by the service provider? Is a mere gap, an ambiguity or a similar form of uncertainty sufficient to give rise to the obligation? Or should the obligation require some inconsistency or incorrectness? An argument for accepting an obligation to warn in the first situation is that the ambiguity or uncertainty brings about the need for a choice, and that it will not be much of an effort for the service provider to consult the client before taking the decision. On the other hand, it would be highly impractical for the service provider to have to consult the client on every choice to be made in the course of the service process. This would also be inconsistent with the system of the preceding Article, which gives both the service provider and the client the possibility to make such choices. So that would be an argument not to accept an obligation to warn in case of a mere gap as to the content of the information or directions.

A third issue is how attentive the service provider should be in analysing the information and instructions, in order to be able to signal a problem that gives rise to an obligation to warn. Is it necessary to focus on gaps, ambiguities, inconsistencies, and mistakes? Is it necessary to search for them? An argument against that proposition would be that an obligation to inform is more costly when the service provider is expected to actively search for possible problems in the information and directions. On the other hand, in many cases the client would be better off if the service provider had such an extended obligation and better able to take advantage of the latter's expertise. But the service provider will not know where gaps or mistakes may be hidden and such a more extensive obligation will therefore be an important burden.

Another issue is whether there should be an obligation to warn if the client already knows of the problem or if the service provider believes that the client already knows of the problem, for instance because the client is more competent than the average client, or is assisted by someone else who has – or is deemed to have – the capacity of a professional

and competent adviser. Imposing an obligation to warn on the service provider would then not only be unnecessary but would also become very costly for the client. But a choice has to be made between an unnecessary warning and the occurrence of a risk that is not discovered in time. In general, the costs of a warning will be insignificant in comparison with the costs of coping with any risk which occurs.

C. Preferred option

The present Article imposes an obligation to warn on the provider of a service. The arguments for doing this have been addressed in Comment B. This obligation has a firm basis in the jurisdictions that have been investigated. (See the Notes below.)

The obligation is triggered by inconsistencies in the information or directions supplied by the client, if it is expected that following the information or directions might lead to a risk that would go to the very heart of the contract from the client's perspective.

The system chosen in most countries is that the service provider only has to warn for inconsistencies actually discovered or for other obvious inconsistencies. This system is attractive because it imposes no extra costs on the service provider. A diligent service provider will have to examine the client's information and directions carefully, because they are the very basis for the service. Inconsistencies that will not escape attention when the information and directions are studied as thoroughly as is necessary to carry them out have to be mentioned to the client. Any active inspection aimed at discovering inconsistencies is therefore not required.

Paragraph (5) provides that the service provider is presumed to be aware of the risks mentioned if they should be obvious from all the facts and circumstances known to the service provider without investigation. The approach adopted here is similar to the concept of 'reason to know' acknowledged in American law (see: Restatement (2nd) Contracts § 19, comment b) where it is clarified as follows. A person has reason to know a fact, if the person has information from which a reasonable person would infer that the fact does or will exist based on all the circumstances, including the overall context and ordinary expectations. 'Reason to know' must be distinguished from knowledge. Knowledge means an actual conscious belief in or awareness of a fact. Reason to know need not entail a conscious belief in or awareness of the existence of the fact or its probable existence in the future. Reason to know is also to be distinguished from 'should know'. 'Should know' imports an obligation to ascertain facts; the term 'reason to know' does not entail or assume an obligation to investigate, but is determined solely by the information available to the party. Under American law, the amount of knowledge expected from the service provider depends on the situation. The person is charged with commercial knowledge of any factors in a particular transaction that in common understanding or ordinary practice are to be expected, including reasonable expectations from usage of trade and course of dealing and widespread business practice. If a person has specialised knowledge or superior intelligence, reason to know is determined in the light of whether a reasonable person with that knowledge or intelligence would draw the inference that the fact does or will exist.

The same approach is adopted for the purpose of establishing whether the client's competence or knowledge is such as to negate the obligation to warn under paragraph (3) in conjunction with (6). The latter provision gives an additional clarification on the question whether, and to what extent, the client can reasonably be expected to know of a risk merely because the client was competent, or was advised by others who were competent, in the relevant field. The principle underlying the rule is that mere competence of the client is insufficient to support the *prima facie* conclusion that the client can reasonably be expected to know of a risk. The same goes for the situation where someone else advises the client. Mere competence of that other person does not automatically lead to the conclusion that the client can reasonably be expected to know of the risk. This is particularly to protect the interests of SME's and consumers who are – often for free – advised by family or friends. The situation becomes different, however, if a client specifically hires a professional adviser for the specific purpose of acting as an agent under the service contract. Any knowledge or competence of such agent will be imputed to the client under paragraph (6) in conjunction with II.–1:105 (Imputed knowledge etc) and this could then negate the obligation to warn of the service provider under paragraph (3).

The burden of proving that the service provider has an obligation to warn is eased to some extent by the presumption in paragraph (5).

This Article contains default rules in principle. However, given the character of the obligation to warn and its basis in good faith, one should not interpret a service contract too easily in the sense that the client has renounced the protection granted under the obligation to warn. It should be noted that the underlying duty of good faith and fair dealing under III.–1:103 (Good faith and fair dealing) cannot be excluded or restricted by contract.

D. Remedies

If the obligation to warn is not performed and the service does not achieve the required result (paragraph (1)(a) there are in fact two obligations the service provider failed to perform: (1) the main obligation and (2) the ancillary obligation under this Article. With regard to the main obligation, the client's supply of incorrect or inconsistent information or directions will normally prevent resort to any remedy because the client will have caused the non-performance. However, in the present situation the client's act is not the only cause of the unfortunate end-result. A secondary cause is the service provider's failure to warn. This justifies the conclusion that the client's remedies remain available. Non-performance of the service provider's main obligation is not excused under III.–3:104 (Excuse due to an impediment) because the impediment was not beyond the service provider's control: a warning could and should have been given. With regard to the non-performance of the service provider's ancillary obligation to warn, the only reason why the client would probably want to claim a remedy on this basis is to obtain damages. Such a claim will be barred, however, if the client also claims damages on the

basis of the non-performance of the service provider's main obligation. The client could not claim double compensation.

If the service provider does not perform the obligation to warn and the risk of paragraph (1)(b) occurs – other interests of the client are damaged – a claim for non-performance of the service provider's main obligation would not provide relief to the client. The client could however seek a remedy for non-performance of the obligation to warn. The main remedy will be damages. In that case the client's supply of incorrect or inconsistent information or directions could be regarded as a contribution to the non-performance or its effects and might therefore reduce the damages payable. (III.–3:704 (Loss attributable to creditor))

Finally, if the service provider fails to warn and the risk referred to in paragraph (1)(c) occurs – the service becomes more expensive or may take more time to perform than agreed on in the contract – the client will not be the one seeking a remedy. In practice it will be the service provider who will try to seek compensation for the loss, particularly if the service was to be performed for a fixed price or on a no result, no pay basis. This is the type of situation for which the rule of paragraph (4) is stated, although the rule is also relevant when the service provider failed to warn for the possible occurrence of any other risk mentioned in paragraph (1). The rule of paragraph (4) prevents the service provider from seeking compensation under IV.C.–2:109 (Unilateral variation of service contract). It is similar to its pre-contractual counterpart under IV.C.–2:102 (Pre-contractual duties to warn). The difference is, however, that when the service provider fails to warn under IV.C.–2:102, a claim for compensation for extra cost and extension of time is still available under IV.C.–2:109 if the service provider proves that the client would have entered into the contract, even if aware of the risk in question. A similar rule has not been adopted in paragraph (4) of the present Article, given that it is intended for the situation where the contract has already been concluded

The rule therefore is that paragraph (4) stops the service provider from claiming compensation of cost and extension of time under IV.C.–2:109 (Unilateral variation of service contract) if extra cost and delay are indeed the consequence of a failure to warn under paragraphs (1) and (2). But there is always the alternative possibility that the service provider tries to claim damages directly for the client's non-performance of the obligation to co-operate. Here, however, the service provider's claim would be affected by the rule of III.–3:704 (Loss attributable to creditor), given that the service provider's failure to warn contributed to the effects of the client's non-performance of the obligation to co-operate. In order to get to a solution that is consistent with the application of the rule under paragraph (4) of the present Article, it would be logical to apply the rule of III.–3:704 to the detriment of the service provider.

IV.C.–2:109: Unilateral variation of the service contract

(1) Without prejudice to the client's right to terminate under IV.C.–2:111 (Client's right to terminate), either party may, by notice to the other party, change the service to be provided, if such a change is reasonable taking into account:

- (a) the result to be achieved;*
- (b) the interests of the client;*
- (c) the interests of the service provider; and*
- (d) the circumstances at the time of the change.*

(2) A change is regarded as reasonable only if it is:

- (a) necessary in order to enable the service provider to act in accordance with IV.C.–2:105 (Obligation of skill and care) or, as the case may be, IV.C.–2:106 (Obligation to achieve result);*
- (b) the consequence of a direction given in accordance with paragraph (1) of IV.C.–2:107 (Directions of the client) and not revoked without undue delay after receipt of a warning in accordance with paragraph (3) of that Article;*
- (c) a reasonable response to a warning from the service provider under IV.C.–2:108 (Contractual obligation of the service provider to warn); or*
- (d) required by a change of circumstances which would justify a variation of the service provider's obligations under III.–1:110 (Variation or termination by court on a change of circumstances).*

(3) Any additional price due as a result of the change has to be reasonable and is to be determined using the same methods of calculation as were used to establish the original price for the service.

(4) In so far as the service is reduced, the loss of profit, the expenses saved and any possibility that the service provider may be able to use the released capacity for other purposes are to be taken into account in the calculation of the price due as a result of the change.

(5) A change of the service may lead to an adjustment of the time of performance proportionate to the extra work required in relation to the work originally required for the performance of the service and the time span determined for performance of the service.

COMMENTS

A. General idea

The performance of the obligations under a service contract frequently extends over a long period of time. Often it becomes apparent that the terms of the contract no longer fit the changing situation. There may be unforeseen difficulties which have to be worked around. The client's needs and wishes may change. The parties can always change the terms of the contract by agreement but in the particular context of a service contract there may be a need for some unilateral power to change the service provider's obligations, subject to an equitable adjustment of the price and other relevant terms. This Article deals with this situation. It enables either party to change the terms relating to the service to be

provided and, in effect, requires the other party to accept that change. However, as a unilateral power to change the terms of a contract is a potentially powerful and undesirable weapon, there are stringent restrictions built into the article.

The situation which arises when a service provider wishes to change the service is similar to the situation of benevolent intervention but differs in that the service provider may be acting largely in the service provider's own interests. Also, the contract sets an initial framework which has to be taken into account.

The client has several protections under the Article. First, the change must be reasonable. In determining whether it is reasonable, paragraph (1) states that the interests of both parties need to be weighed and balanced. Secondly, a client who is not willing to accept a change may walk away from the contract in any event using the right to terminate under IV.C.-2:111 (Client's right to terminate). This is made clear by the opening words of paragraph (1). The client is also protected from variations due to circumstances of which the service provider ought to have given a pre-contractual warning. See paragraph (3) of IV.C.-2:102 (Pre-contractual duties to warn). Finally, the client is protected by the restricted definition in paragraph (2) of what is regarded as reasonable.

The interests of the service provider who objects to a change are protected by the reasonableness requirement and are further protected by the provisions of paragraphs (3), (4), and (5) as explained below.

Paragraph (2) identifies various situations in which a change of the contract is regarded as reasonable.

Paragraph (2)(a) deals with the situation where the service provider is prevented from performing the main obligation under the contract *at all* due to a cause that has nothing to do with the failure of either party to perform a duty or obligation prior to or after the conclusion of the contract.

Illustration 1

An engineer is ordered to repair the defective part of a conveyor belt. The purpose of the job is clearly to get the conveyor belt moving again. While performing the service, the engineer discovers that the repair of the specific part will not bring the conveyor belt back into operation, given that another part of the belt is defective as well. When the parties entered into the contract, however, they did not agree on the repair of this other defective part. Moreover, this latter defect was not something that could be expected to be noticed by the engineer at the time of conclusion of the contract. Repair of the second defect will cost extra and also delay the service. The engineer may change the service and repair the other defective part.

Paragraph (2)(b) identifies a second situation in which a change of the contract by the service provider is regarded as reasonable. If the client gives the service provider a direction which would lead to a variation of the contract, the service provider must warn the client that that would be the result. If the client does not revoke the direction, the service provider may vary the contract accordingly and the variation is deemed to be reasonable.

Illustration 2

A real estate agent is asked by a growing law firm to find a suitable office building in the area of Berlin. The law firm would like to locate itself within a maximum distance of 5 kilometres from the German capital. After a few weeks, the firm directs the agent to look for a possible location 'in either Berlin, Munich or Frankfurt'. The agent informs the law firm that this sudden switch of preference will lead to an increase in the required search activities, and that it will cost extra to carry out the adjusted service. The client does not revoke the direction. The agent may vary the contract accordingly.

A third situation is the one referred to in paragraph (2)(c). The client may need to initiate a change of the contract in response to a risk about which the service provider has given a warning. In so far as that change is a reasonable response to the warning, it is deemed to be a reasonable variation of the terms of the contract.

Illustration 3

A geo-technical surveyor is asked by a client to investigate the subsoil conditions of a piece of land which the client would like to use for the erection of a building. The client designates the exact area to be investigated. While performing the investigation, the surveyor discovers the presence of a small stream below the surface of the land investigated. The origin of the stream is located somewhere outside the area designated for investigation. The surveyor warns the client that further investigation of the stream is needed in order to find out its effects on a possible future building. This further investigation, however, is outside the scope of the present service contract. Hence the client expands the surveyor's task under the contract. That is deemed to be a reasonable variation.

There is a fourth situation in which a change of the contract is deemed to be reasonable. This is where there has been a change of circumstances which would justify a variation of the service provider's obligations under III.-1:110 (Variation or termination by court on a change of circumstances). The reference to this Article is made in order to provide flexibility while preventing the service provider from shifting all kinds of risks to the client – besides the ones that fall within the boundaries of the situations already described above. It has to be established that performance of the contractual obligations has become excessively onerous because of a change of circumstances which should not be for the service provider's account.

All the situations set out above are subject to paragraphs (3), (4), and (5) of the present Article, providing rules for the consequences of a reasonable change of the contract.

Paragraphs (3) and (4) deal with adjustment of the price. The rule of paragraph (3) basically states that the new price has to be reasonable and has to be calculated in accordance with the method used to determine the original price. A change of a contract may result in either an increase or a decrease of the price. If the change of the contract would lead to extra work for the service provider, the remuneration would increase accordingly. In addition, it has to be taken into account that the service provider may have other than financial interests at stake, for instance because there are contracts with other clients and insufficient time and staff to perform the extra work that results from the change. If the change of the contract implies a reduction of the service, the rule of paragraph (4) states that the parties will have to take into account the expenses spared as a result of the reduction, the loss of profit for the service provider, and the options the service provider has available to use earning capacity otherwise.

Paragraph (5) deals with the consequences of the change of the contract on the time for performance, if the change results in an increase of the work to be performed under the contract. An extension of time will then have to be granted to the service provider to the extent that extra time is needed to carry out the changed service, taking into account the time for performance agreed upon for the initial service.

B. Interests at stake and policy considerations

A change of the service to be supplied under a service contract is a frequently occurring situation. Changes initiated by the client are usually not a problem, provided that the service provider gives a warning to the client as regards the consequences of such initiatives.

Changes of the service become an issue, however, if they are rooted in undesired circumstances that are outside the control of the parties. One could question whether it is then desirable to have a rule that forces either the one party or the other to accept the change of the service. The alternative would be to leave changes to the agreement of the parties. The main objection to a unilateral power to vary is of course that a forced change of the service could lead to a non-voluntary change of the mutual obligations under the contract. On the other hand, if these obligations have become unbalanced due to the event that gives rise to the change of the service, general contract law does not oppose the changing of the contract, provided that this is done having regard to concepts of fairness and reasonableness.

This brings up the related issue whether it is necessary to have a separate rule for service contracts stating that a change of circumstances in accordance with III.-1:110 (Variation or termination by court on a change of circumstances) is deemed to justify a unilateral change of the service, allowing the service provider to ask for extra payment and extension of time under paragraphs (3), (4), and (5) of the present Article. One could

argue that such a rule is not needed, given that III.–1:110 already provides a solution. On the other hand, one could argue that the latter provision needs particularisation in the context of service contracts, especially since III.–1:110 would require the party instigating the change to rely on the courts, which would have discretionary powers here. This is rather impractical in the case of a service contract which is already being performed.

C. Preferred option

It is thought wise to have a rule that allows for unilateral variation of the service in a number of situations, provided that the power to vary is limited and that the interests of the parties are kept in balance. The rules of the Article try to do this. The interests of the client in particular are safeguarded by the various restrictions built into the Article. It is worth bearing in mind that the client always has the right to terminate the contractual relationship under IV.C.–2:111 (Client’s right to terminate) even if a proposed change of the service is considered to be reasonable.

It is thought that the rule in paragraph (2)(d) of the present Article is needed in order to allow the service provider – in the event of a change of circumstances – to ask for extra payment and extension of time under paragraph (3), (4), and (5). It is true that III.–1:110 (Variation or termination by court on a change of circumstances) provides a general remedy in the event of an exceptional change of circumstances, but that Article is intended to apply only to exceptional cases and requires an application to a court. Going to court is a final and radical option, which would take a considerable amount of time. In the meantime, the service provider is still in the middle of the performance of a service contract which is costing extra money and time. It seems reasonable to protect the service provider’s interests by allowing recovery for these extras directly under paragraph (2). This might also give an incentive to the client to reconsider the future of the contractual relationship given that the client has the escape route of termination.

IV.C.–2:110: Client’s obligation to notify anticipated non-conformity

(1) The client must notify the service provider if the client becomes aware during the period for performance of the service that the service provider will fail to perform the obligation under IV.C.–2:106 (Obligation to achieve result).

(2) The client is presumed to be so aware if from all the facts and circumstances known to the client without investigation the client has reason to be so aware.

(3) If a non-performance of the obligation under paragraph (1) causes the service to become more expensive or to take more time than agreed on in the contract, the service provider is entitled to:

- (a) damages for the loss the service provider sustains as a consequence of that failure;*
- and*
- (b) an adjustment of the time allowed for performance of the service.*

COMMENTS

A. General idea

This Article deals with the situation where the client becomes aware during the performance of the service that the service provider is going to fail to achieve the required result. The client has an obligation to notify the service provider of that fact. This is an aspect of the obligation to co-operate.

This situation must be distinguished from the situation which arises when the client becomes aware of a non-conformity after the period for performance of the service has ended. There is then a requirement to notify the service provider within a reasonable time if the client is not to lose remedies. This is an aspect of the duty to exercise remedies in good faith and is dealt with by the general provision in III.-3:107 (Failure to notify non-conformity). Article III.-3:107 does not apply to consumers: in their case only the general rule on good faith and fair dealing and the rules applicable to particular remedies or particular situations apply.

The justification for the obligation imposed by this Article is fairness to the service provider. Correct performance of the contractual obligations may still be possible, provided that the risk is brought to the attention of the service provider.

Illustration 1

A client has entered into a contract with a lawyer for the purpose of bringing a case to court. The court of first instance dismisses the client's case. The lawyer tells the client that it is possible to appeal within 6 weeks of the date of the court's decision. After 3 weeks, the client reads the court's decision and finds out that the appeal must be made within 4 weeks of the date of the decision.

The client will only have to notify, however, if the client becomes aware of the likely non-conformity, taking into account the presumption in paragraph (2). The client is not bound to investigate whether or not the service provider is carrying out the service in accordance with the obligations imposed. But if the client actually follows what is happening in the service process, as a consequence of the communication that will sometimes necessarily have to take place, the client should be normally attentive.

If the client does not perform the obligation under paragraph (1), the service provider may be prejudiced. This is where paragraph (3) becomes relevant. A further possibility is that the client notifies the service provider before the service process has finished, but does so too late.

Illustration 3

A client has entered into a contract for a fixed price with a builder for the purpose of designing and building a house with two floors. The client has asked the

builder to design a large window in the roof of the house. The client needs that large window for his hobby: artistic painting. When the builder presents the first basic design to the client, the paper shows no window in the roof. The client does not mention this to the builder, who continues with the service by making a more detailed design and by submitting that design to the local authorities for the purpose of obtaining building permission. At that stage, the client tells the builder that he has noticed the absence of the large window. The builder can adjust the design, but he will have to make extra technical calculations. Moreover, he will have to restart the procedure of asking for building permission.

The service provider might still be able to perform the main obligation under the contract, but it is likely that the service will have become more costly and that more time will be needed to achieve the required result. This will not cause problems if payment of a fee based on an hourly rate was agreed upon at the time of conclusion of the contract. But if payment of either a fixed price or a fee based on a no result, no pay basis was agreed, the service provider would incur a loss due to the client's late notification. The service provider may then claim compensation for that loss or extension of the time to perform the service or both (paragraph (3)).

B. Interests at stake and policy considerations

The question is whether it is necessary to impose an obligation on the client to notify the service provider of anticipated non-performance while the service is still underway. It is true that the interests of both parties to the service contract are met when the client signals that performance of the service may not lead to the outcome required. But it is also true that it is the service provider's job to achieve that result, and that it may be considered undesirable to burden the client with taking care of problems which should be dealt with by the service provider. Moreover, imposing an obligation to notify on the client in the course of the service process raises the question whether and to what extent the client must also investigate the performance of the service in order to discover failures that could be the object of notification.

C. Preferred option

If the client discovers in the course of the service process that there is a risk that the required result might not be achieved, it would be inefficient to allow the client to refrain from notifying the service provider. The client will generally have ample opportunity to find out that there might be a problem with the performance of the service. At the same time, the service provider has the prime responsibility for the performance of the service. The service provider should not be allowed to shift that responsibility to the client, by stating that the latter failed to discover a risk of non-performance in the course of the service process. It is thought inefficient to actually impose a duty to investigate on the client. The responsibility of the service provider can only be mitigated by the non-performance of the client's obligation to notify of a likely failure to achieve the required result. This latter obligation is only imposed on the client if the client becomes aware of the failure. It would not make sense to impose an obligation to notify something of which the client was unaware. That would be an obligation to do the impossible. However, the client is presumed to be aware of a failure or a risk of failure if from all the facts and

circumstances known to the client without investigation the client has reason to be aware of it. This latter approach is similar in effect to the concept of ‘Reason to Know’ that is acknowledged in American law (see: Restatement (2nd) Contracts § 19, comment b). In the context of the client’s obligation to notify under the present Article, it implies that the client will have to give notice of any failure that leaps to the eye whenever the service process is checked or followed. It also implies that if, for instance, the client decides not to take advantage of an opportunity to check the process of the performance under IV.C.–2:103 (Obligation to co-operate) paragraph (1)(d), there will be less possibility for the service provider to allege that the client had reason to know of a non-performance and must be presumed to have been aware of it.

D. Remedies

The consequences of a non-performance of the obligation to notify an anticipated failure to achieve the required result are set out in paragraph (3) of the Article. If the client fails promptly to notify the service provider that the latter will fail to achieve the result stated or envisaged by the client, causing the service to become more expensive or to take more time than agreed on in the contract, the service provider is entitled to claim both compensation for the loss incurred and extension of time to perform the obligations under the contract. The service provider would be entitled to damages anyway under the general rules on remedies for non-performance of an obligation but the right is restated here for the sake of completeness.

There are in Book III various provisions which might result in a remedy not being available or being lost or diminished if the creditor does not give notice to the debtor. See e.g. III.–1:103 (Good faith and fair dealing) paragraph (3); III.–3:101 (Remedies available) paragraph (3); III.–3:107 (Failure to notify non-conformity); III.–3:302 (Non-monetary obligations) paragraph (4); III.–3:508 (Loss of right to terminate); III.–3:704 (Loss attributable to creditor). These provisions are not affected by the present Article. The present Article does not itself, however, provide for a client to lose any remedies as a result of a failure to notify of an anticipated failure to achieve the required result.

IV.C.–2:111: Client’s right to terminate

(1) The client may terminate the contractual relationship at any time by giving notice to the service provider.

(2) The effects of termination are governed by III.–1:109 (Variation or termination by notice) paragraph (3).

(3) When the client was justified in terminating the relationship no damages are payable for so doing.

(4) When the client was not justified in terminating the relationship, the termination is nevertheless effective but, the service provider may claim damages in accordance with the rules in Book III.

(5) For the purposes of this Article, the client is justified in terminating the relationship if the client:

(a) was entitled to terminate the relationship under the express terms of the contract and observed any requirements laid down in the contract for doing so;

(b) was entitled to terminate the relationship under Book III, Chapter 3, Section 5 (Termination); or

(c) was entitled to terminate the relationship under III.–1:109 (Variation or termination by notice) paragraph (2) and gave a reasonable period of notice as required by that provision.

COMMENTS

A. General idea

Paragraph (1) of this Article gives the client the right to terminate the contractual relationship at any time. This is quite distinct from any right there may be to terminate for fundamental non-performance or the equivalent under Book III, Chapter 3. The client’s right to terminate under the present Article does not depend on any non-performance by the service provider. The client under the present Article has the option of termination whenever the client would like to walk away from the contract for any reason, whether or not there is an alleged non-performance on the side of the service provider.

Illustration

A house owner has entered into a contract with an architect for the purpose of designing an extension to the house. After a few weeks, the house owner decides he no longer wants to have the extension and terminates his contractual relationship with the architect.

Termination under this Article is therefore not to be regarded as a remedy. It is basically a recognition of the fact that the client may no longer want the service to be performed

even though the service provider is adequately performing the obligations under the contract.

The client, however, will have to pay the price for walking away from the contract. Firstly, the normal restitutionary rules will apply. What has been transferred under the contract will have to be returned. The service provider will be entitled to the value of any services rendered or any other non-transferable benefits conferred on the client. This is the effect of paragraph (2) and it is the same whether or not the client had other grounds for termination. Secondly, where the client was not justified under paragraph (5) in terminating the relationship the client will have to pay damages to the service provider to ensure that the service provider will not lose by virtue of the client's exercise of the right to terminate without cause (paragraph (4)). The situations in which the client would have been justified in terminating under paragraph (5), and will consequently not be liable to pay damages for terminating (paragraph (3)), are (a) where termination was allowed by the express terms of the contract and the client observed any requirements set out in the contract (such as giving a prescribed period of notice) (b) where the client was entitled to terminate the relationship under Book III, Chapter 3, Section 5, which deals with termination for fundamental non-performance or the equivalent and (c) where the client was entitled to terminate the relationship under III.-1:109 (Variation or termination by notice) paragraph (2), which deals with contracts of indefinite duration, and gave a reasonable period of notice as required by that provision. (Termination of the relationship arising under a contract of indefinite duration by giving an *inadequate* period of notice would come under the present Article and would give rise to a right to damages.) Paragraph (4) applies the normal rules on damages. This means that the service provider is entitled to be put as nearly as possible into the situation which would have prevailed if the contractual obligations had been duly performed. The compensation payable is to cover the loss which the service provider has suffered and the gain of which the service provider has been deprived. In other words, the client must reimburse both the costs already incurred by the service provider as a consequence of carrying out the service and any profit lost as a consequence of the termination.

B. Interests at stake and policy considerations

The main issue is whether the client should be allowed to terminate without cause. It could be asked what is so special about service contracts that the client should be entitled to unilaterally bring the contractual relationship to an end for no reason. The normal rule is that, unless conferred by the contract, such a right exists only for contracts concluded for an indefinite period. (See III.-1:109 (Variation or termination by notice) paragraph (2).)

On the other hand, circumstances may change after the conclusion of the service contract and may give the client a legitimate interest in terminating. It is true that this situation could also arise under any other type of contract – for instance a sales contract – but in such a case a party sometimes has other options to deal with the new situation, without having to terminate the contractual relationship. A buyer could for instance still buy the things but subsequently resell them. Reselling the finished – though unwanted – result of

a completed service, however, will not always be practically possible. Also, a client will not always be sufficiently protected either by ordering a change of the contract under the provisions permitting this or by renegotiating the contract. Hence termination could be regarded as a useful instrument, particularly if the service provider's financial interests are also sufficiently protected.

C. Preferred option

The client's right to terminate the contractual relationship is accepted in principle in paragraph (1) of the present Article. The arguments in favour of that position have been set out above and have been put forward in various legal systems. The client's right is balanced by the rules in paragraphs (4) and (5) allowing the service provider financial compensation for the consequences of an unjustified termination. This approach is followed in many legal systems.

The actual results under the system adopted in the Article will in most cases be the same as the results which would be reached by saying that the client had no right to terminate without cause. If that other approach were adopted the client could still in practice repudiate the contract and withdraw co-operation. The client would then have to pay damages, on exactly the same basis, for non-performance or anticipated non-performance of the client's contractual obligations. The difference between the two systems lies in specific performance. Under the alternative system the client would, in some unusual types of case, have to accept performance of an unwanted service. This could happen if the service was not of such a personal nature that it would be unreasonable to enforce specific performance of the client's obligation to co-operate and if the service provider had such a legitimate interest in continuing performance that it would be reasonable to allow the service provider to recover payment for the unwanted service. (See III.-3:301 (Monetary obligations) and III.-3:302 (Non-monetary obligations.)) The approach adopted in the present Article places the client's interest in not having to accept a service which is no longer wanted above the service provider's interest in being able to continue to provide it, while recognising that the service provider is always entitled to restitution of anything provided under the contract and full monetary compensation for any loss caused by an unjustified termination. Even if there were to be no right to enforce specific performance of the client's obligations under a service contract, the approach adopted in the present Article would be preferable because it is more likely to promote respect for the law. It openly confers a right to terminate on paying compensation, rather than pretending that there is no such right but covertly giving it by pointing out that the client can choose to fail to perform the obligations under the contract.

D. Other relevant provision

The provisions on notice in Book II include a provision to the effect that notice becomes effective when it reaches the addressee, unless it provides for a delayed effect. II.-1:106 (Notice) paragraph (2). So the client can either cancel immediately or give a period of notice. The notice may be given by any means appropriate to the circumstances. (II.-1:106 (Notice) paragraph (3)).

The effects of termination under III.–1:109 (Variation or termination by notice) paragraph (3) are as follows. Where the parties do not regulate the effects of termination, then:

- (a) it has prospective effect only and does not affect any right to damages, or a stipulated payment, for non-performance of any obligation performance of which was due before termination;
- (b) it does not affect any provision for the settlement of disputes or any other provision which is to operate even after termination; and
- (c) in the case of a contractual obligation or relationship any restitutionary effects are regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) with appropriate adaptations.

The restitutionary effects include payment (by reference to the contractual rate) for any services which had already been rendered by the time of termination but for which payment had not yet fallen due. (III.–3:513 (Payment of value of benefit)). As termination has prospective effect only, any payments which had fallen due by the time of termination would still remain due.

CHAPTER 3: CONSTRUCTION

IV.C.–3:101: Scope

(1) This Chapter applies to contracts under which one party, the constructor, undertakes to construct a building or other immovable structure, or to materially alter an existing building or other immovable structure, following a design provided by the client.

(2) It applies with appropriate adaptations to contracts under which the constructor undertakes:

- (a) to construct a movable or incorporeal thing, following a design provided by the client; or*
- (b) to construct a building or other immovable structure, to materially alter an existing building or other immovable structure, or to construct a movable or incorporeal thing, following a design provided by the constructor.*

COMMENTS

A. General idea

A contract for construction is defined in Annex 1 as “a contract under which one party, the constructor, undertakes to construct something for another party, the client, or to materially alter an existing building or other immovable structure for a client”. However, this Chapter does not apply to all construction contracts in precisely the same way. The present Article, which is a “scope” provision rather than a “definition” provision, sets out

its primary area of application and those cases where it applies “with appropriate adaptations”.

This Chapter covers services whose aim it is to bring about a new structure or thing. The core area of application is the building of immovable structures, based on a design by an architect hired by the client or a design otherwise provided by the client.

Illustration 1

The building of houses, offices, roads and other infrastructure are examples of activities falling under this Chapter.

The rules are drafted in such a manner, however, that they can also be applied, with any appropriate adaptations, to the construction of movable or incorporeal things.

Illustration 2

The construction of tailor-made machinery, software and websites are examples of this.

The rules can also be applied to the construction element in mixed contracts, including ‘design and construct’ contracts, where the constructor is also responsible for the design of the structure. On mixed contracts generally, see II.–1:108 (Mixed contracts) and on contracts for construction and sale, see IV.A.–1:102 (Goods to be manufactured or produced).

B. Interests at stake and policy considerations

This Article covers the scope of application of the rules on construction. The main policy issue is whether the rules should only cover the building of immovables or also the formation of other structures and things. A limited scope of application would be supported by the argument that extensive case law exists on building contracts, so that there is a firm basis for codification in this field. However, many activities which are very similar economically – in the sense that they are also oriented towards creating an object and require very similar interaction processes between the parties in order to achieve this – would then be excluded from the application of this Chapter: the building of ships, aeroplanes and machinery or the construction of software, databases, websites and the like.

C. Preferred option

In the present Article, the solution chosen is that of a main scope of application for the rules on construction, that is, building contracts regarding immovables. Outside this scope, the rules are applicable with ‘appropriate adaptations’ to other construction activities. This solution reflects the idea that such activities are very similar economically, require very similar interaction processes between the parties in order to effectuate the envisaged structure and therefore can be governed by similar rules. At the same time, the solution acknowledges that the law regarding such activities is less well

established, that these activities relate to many different objects and that the relevant business practices may vary considerably. Thus, although it is very likely that the rules can be applied without modification to those situations, the rules may need to be adapted to these specific situations by the courts.

The rules of this Chapter may apply to the construction of software. An appropriate modification may be warranted for the conformity rule, in situations where the software is highly innovative, for instance. If the construction of the software entailed substantial risk, a court may find that the ‘fitness for purpose’ test is too harsh for the provider of the software. A court may try to find an appropriate solution by looking to the result stated or envisaged by the client or by applying the general rule on the standard of care and skill required of a service provider.

D. Relation to other parts of the model rules

Construction contracts, and the rights and obligations arising from them, are governed by the general rules in Books I to III, by the rules on service contracts contained in Chapter 1 of the present Part of Book IV and by the specific rules of the present Chapter.

The question of mixed contracts is dealt with generally in II.–1:108 (Mixed contracts). The rules on mixed contracts are intended to apply not only to contracts which are partly for services and partly for something else but also to contracts which are wholly service contracts but which are partly for a construction service and partly for another service. The rules in the present Chapter will apply to the construction part of the service.

E. Design by the client or the constructor

The main area of application is delimited further by presupposing that what is to be constructed is designed by the client or by an agent of the client, such as an architect. In these situations, the structure to be made is defined by the client to a greater or lesser extent and the choices made by the client are part of the initial contract or become binding on the constructor by way of directions. In these situations, the client generally bears the risk of mistakes in the design, unless the constructor has a duty to warn.

If the structure is only described in a more general manner and the constructor is to design the structure before the construction work begins, the rules of the present Chapter apply with appropriate adaptations. Generally, however, no adaptations will be necessary for such ‘turnkey’ or ‘design and construct’ contracts. In these contracts, the constructor will bear more responsibility for the result. That, however, is exactly what the present rules lead to. According to these rules, the responsibility for the design shifts to the constructor because the contract only describes the construction in general terms and it is the constructor who has the responsibility to ensure that the design is such that the structure becomes fit for its purpose. In situations where the designer and the constructor are one and the same person or entity, the rules of Chapter 6 (Design) are not applicable to the ‘design’ part of the work undertaken by the constructor. These rules are only applicable when the designer and the constructor are different persons or entities.

F. Construction work on existing immovables or processing?

The rules of this Chapter also apply to contracts whereby the constructor is to perform construction work on an existing building or other immovable structure, following a design provided by the client. In general, processes applied to existing structures and things are covered by the rules on processing. So, maintenance work on buildings, such as painting, repairs to sewage systems and wiring and the cleaning of windows, is classified as processing. Extensive reparations, however, such as the removal and renewal of an entire roof structure or restoration work on old buildings with a value similar to the value of the building prior to the restoration, constitute construction work covered by the present Chapter because it is more similar to construction than to processing.

The exact borderline between construction and processing may, in some situations, be difficult to determine. At this borderline, however, the rules regarding processing and construction are very similar. Processing services which are similar to construction work on existing immovables will consist mainly of repairs. Contracts involving important repairs to buildings will generally be successful, so that a reasonable client will have no reason to believe that the result will not be achieved by the service provider. Thus, the repairer will generally be under an obligation to achieve a specific result, as would also be the case for the constructor under the regime of the present Chapter.

IV.C.–3:102: Obligation of client to co-operate

The obligation of co-operation requires in particular the client to:

- (a) provide access to the site where the construction has to take place in so far as this may reasonably be considered necessary to enable the constructor to perform the obligations under the contract; and*
- (b) provide the components, materials and tools, in so far as they must be provided by the client, at such time as may reasonably be considered necessary to enable the constructor to perform the obligations under the contract.*

COMMENTS

A. General idea

This Article sets out specific instances of the general obligation to co-operate in III.–1:104 (Co-operation), as already particularised for services in general in IV.C.–2:103 (Obligation to co-operate). From the latter Article, it is already clear that the client must answer reasonable requests for information by the constructor, for instance regarding the existing situation. Moreover, directions – such as drawings or other specifications to be delivered by an architect – should be given in good time. The same holds for permits and licences. The constructor is to enable the client to follow the construction process in order to determine whether the constructor is performing the obligations under the contract. The parties are also to co-ordinate their efforts.

The present Article mentions two additional issues for which the co-operation of the client is essential. The client must provide access to the construction site and, in so far as the client is to provide components, materials and tools, must provide these in time.

Illustration

The owner of a farm wants a constructor to build a shed on his premises. The constructor is to use the wood from the old shed, which the owner will tear down himself. The owner must give the constructor access to the place where the shed is to be built and must deliver the wood in time.

B. Interests at stake and policy considerations

Access to the input provided by the client, and to the construction site, are particular examples of essential co-operation. If such access is not given in good time, the construction process may be delayed, and the constructor may be precluded from using the workforce and other resources optimally. The issue is whether the constructor or the client is to have the primary responsibility for organising these efforts.

C. Preferred option

Both specific instances of co-operation mentioned in this Article are essential elements of a well co-ordinated construction effort. Placing this burden on the client is a solution that is sufficiently supported by construction law in various jurisdictions. There are no indications that such duties are contested in other jurisdictions. The client usually is in the best position to ensure that these elements of the co-operation are taken care of.

D. Other issues for co-operation

Apart from the topics mentioned in the Article, there are other issues for co-operation. When undertaking construction activities, the parties may find it useful to design procedures for some aspects of co-operation. In standard conditions, it is common to have a detailed procedure for handing over of the structure, for inspection of the end result, for complaints resulting from this inspection, for discussing the progress of the project and for recording the outcomes of such discussions. Whether such elaborate procedures are useful and which procedures are pertinent depends on the size of the construction project and the ability of the parties to meet the procedural requirements. The costs of designing and implementing these procedures should be weighed against the expected benefits. Keeping written records of all the essential communications that take place is costly, but may lead to important savings in dealing with quality problems and other potential disputes later on.

Procedures for directions, variations, inspections, acceptance and handing over of the structure are very common in the standard conditions, but this is not yet the case with provisions regarding disputes, with the exception of arrangements regarding the court or arbitration tribunal that should deal with disputes and the law applicable. In the construction industry, and also in the software business, there is an increasing awareness of the necessity to solve disputes early and in an efficient manner. This is reflected in the development of the concept of 'Partnering' and in the establishment of 'Dispute Review

Boards' for larger construction projects. Stimulating co-operation through the development of such procedures, or resorting to them when disputes arise, may be very useful.

IV.C.–3:103: Obligation to prevent damage to structure

The constructor must take reasonable precautions in order to prevent any damage to the structure.

COMMENTS

A. General idea

The general rule for all service contracts in IV.C.–2:105 (Obligation of skill and care) already requires the constructor to comply with the statutory and disciplinary rules applicable to the activity (paragraph (1)(b)), and to take reasonable precautions in order to prevent the occurrence of damage as a consequence of the performance of the service. During the construction activity, the constructor must also take reasonable precautions against foreseeable damage to the structure.

Illustration

The constructor of a building is to protect the structure against external harm such as weather conditions and theft. This may require the building site to be covered in a way that protects it against rain and wind. If valuable materials are present on the site, the site may have to be fenced or even guarded.

B. Interests at stake and policy considerations

When construction activities take place, the risk of damage to the structure is usually higher than when the building is completed and in use. The structure is generally more easily accessible, more exposed to the elements and less stable than a completed building. Protection is therefore needed. The issue is: who is to provide protection, the constructor or the client?

Because the constructor will normally supervise the site where construction takes place, or at least the structure, and will also be accessing the structure regularly and frequently, the constructor is usually in the best position to take protective measures.

More generally, the constructor is usually in the best position to take safety measures and measures limiting a negative impact of the activity on goods and on third parties. Construction, by its nature, is a process which easily leads to damage to goods or even personal injury. The constructor will have to protect the constructors own materials and workforce anyhow, and protecting other goods and people is therefore not burdensome. Insurance cover is widely available. In exceptional cases, the client may be in a better

position to take safety measures, and the parties may then wish to deviate from this default regime.

C. Preferred option

According to this Article, the constructor is the one who has the principal responsibility for safeguarding the structure during construction, for the reasons set out under B.

IV.C.–3:104: Conformity

(1) The constructor must ensure that the structure is of the quality and description required by the contract. Where more than one structure is to be made, the quantity also must be in conformity with the contract.

(2) The structure does not conform to the contract unless it is:

(a) fit for any particular purpose expressly or impliedly made known to the constructor at the time of the conclusion of the contract or at the time of any variation in accordance with IV.C.–2:109 (Unilateral variation of the service contract) pertaining to the issue in question; and

(b) fit for the particular purpose or purposes for which a structure of the same description would ordinarily be used.

(3) The client is not entitled to invoke a remedy for non-conformity if a direction provided by the client under IV.C.–2:107 (Directions of the client) is the cause of the non-conformity and the constructor performed the obligation to warn pursuant to IV.C.–2:108 (Contractual obligation of the service provider to warn).

COMMENTS

A. General idea

This is one of the central rules on construction. The constructor is to guarantee the fitness for purpose of the structure. When the structure is not fit for its purpose, the constructor will have to prove that the cause of that was beyond the constructor's control. The rule is a specific application and refinement of IV.C.–2:106 (Obligation to achieve result). The client may expect that the result will be achieved.

The structure must conform to a particular purpose made known to the constructor at the time of conclusion of the contract. If such a particular purpose is made known to the constructor at a later time, the constructor is obliged to make sure the structure will be fit for that particular purpose if the content of the contract is changed in accordance with IV.C.–2:109 (Unilateral variation of the service contract).

Furthermore, the structure must be fit for the purpose or purposes for which a structure of the same description would normally be used. Without indications to the contrary, the

client may reasonably expect that the structure will be fit for such a normal purpose. If the constructor is not able to render the structure fit for such a purpose, the client should be so informed.

Illustration 1

A client and a shipbuilder agreed on a contract for the construction of a large sailing ship. The client may expect a sufficiently large sailing ship to be seaworthy. If the client made known to the shipbuilder that he wishes to use the ship for trips with groups consisting of a maximum of ten people, he may expect the ship to offer sufficient sleeping and sitting space for ten persons, albeit perhaps in shifts.

Similarly, the structure does not conform to the contract if a part or component is not fit for its particular or normal purpose, even though the whole structure may be fit for its purpose. Of course, such a partial non-conformity would only lead to an adjusted remedy.

B. Interests at stake and policy considerations

Liability with regard to the quality of the outcome is an important issue for both parties. When the liability for the quality is strict, the constructor will have to remedy defects even when every relevant quality criterion was met regarding the assessment of the existing situation, the input and the process of construction. The only escape is to show that specific defences apply. When there is no liability for ‘fitness for purpose’, the central issue will be whether the constructor satisfied the quality criteria set for the activities. In practice, the difference between the two approaches should not be overstated, especially when the burden of proving that the duties were performed is on the constructor. In that case, the question is rather which defences are allowed under both regimes.

An advantage of the former approach is that the quality of the outcome may be easier to discuss and to establish than the quality of the processes and interactions that led to that outcome. It may, for instance, be hard to reconstruct the events that preceded the apparent defect in the outcome and to what extent the constructor exercised care with respect to these events. So, the legal and other administrative costs of the stricter liability system are likely to be lower. Another issue to take into account is the possibility of insurance. In most countries, there is ‘construction all risk’ coverage available with regard to the risks of construction of buildings. In France, this coverage is even obligatory for most building projects.

The costs of stricter liability and insurance will be reflected in the price. So, accepting the former system will lead to somewhat higher prices of construction. There may be only an effect on the initial price, however. Under a fault liability for defects, the client will in many cases let the constructor repair the defects anyhow, because the client will wish to obtain a structure that is fit for its purpose. Thus, the client will in most cases pay the extra price for remedying, even if this is under the heading of costs for extra work and not

under the heading of an element of the initial price intended for coverage of the stricter liability.

Whether liability for the fitness for purpose of the outcome or an obligation of means is the more acceptable system will also depend on the frequency of constructors not being able to attain the result envisaged. When it is normally relatively easy for the constructor to construct a structure that is fit for its purpose, stricter liability is more acceptable than in situations where it is rather uncertain whether a structure will be fit for its purpose. Taking normal precautions in most circumstances may prevent major defects. This may be different for highly innovative structures or things, such as entirely new and tailor-made machinery or software, but in such situations special contractual arrangements will be necessary anyhow, and the parties can adjust the liability regime to these specific needs. In many construction projects, the problem will rather be that some small defects are virtually unavoidable. The main issue there is probably who is generally in the best position to prevent as many of these defects as possible. Furthermore, it is a matter of how the various solutions work in terms of costs of sorting out whether the constructor is liable and, if not, of negotiating for extra work.

A related issue is the extent of control the constructor has over the construction process. If the client or experts hired by the client make decisions on the design and on the other input, the constructor may have less influence on the final outcome. Whether this should lead to diminished liability will depend to some extent on the care expected from the constructor with respect to input and instructions from the client. This issue is generally covered by the constructor's obligation to warn; see IV.C.-2:108 (Contractual obligation of the service provider to warn).

C. Comparative overview

The principle that the final outcome of the construction process (the structure) should be fit for its purpose or – which amounts to the same thing – should not contain defects is a central idea in French, Spanish, German, Austrian and Greek law. In these countries, the constructor has an obligation to construct a structure that is fit for its intended use, which may be either the purpose for which it is generally considered to be used or a specific purpose for this specific structure. Therefore, in these countries the principle of perfect final result is accepted: the constructor is under an *obligation de résultat*. This implies that the constructor will be liable unless the constructor proves that the client's specifications were the cause of the problem and amount to an impediment beyond the constructor's control, excusing the bad performance as *force majeure*. Whether *force majeure* can be proved of course heavily depends upon the way in which the concept is interpreted.

Although English courts now apply the 'fitness for purpose' test to the building of houses and some other structures, the traditional rule in English law is different. If the client provides the constructor with more or less detailed instructions, the constructor is not under an obligation to produce a structure which is fit for its purpose, but is only bound to prove that the work was carried out in accordance with the plans and specifications in a

workmanlike manner, using proper materials. If the constructor proves that the instructions were followed conscientiously and that proper care was exercised, the constructor will not be liable if the structure is not fit for its purpose. Where the client, however, relies on the constructor's skill and judgement, such as in a contract to build a house for use by the client, there will be an implied warranty that the house will be reasonably fit for its purpose. In Belgium, the Netherlands and Sweden, the systems are in between the English and the 'obligation of result' system.

Under the English system, the constructor can avoid liability by proving that the work was carried out in accordance with the quality requirements set in the contract. With respect to those issues on which the contract is silent, the constructor has to prove that high-quality materials were used and processed in a good and workmanlike manner, which includes warning the client against apparent defects in instructions or other input from his side. Swedish, Spanish, Portuguese, German and Dutch law give the constructor the possibility of proving that the defect is caused by contractual requirements or other decisions for which the client is responsible, unless the constructor had to warn the client against the possible defects resulting from this. The French system is different in that it allows a defence based on decisions for which the client is responsible only when the client knew or had reason to know the unsuitability of the decision – a rule that is seldom applied. All systems are similar in that they allow a defence in real *force majeure* cases, which, however, are extremely rare.

D. Preferred option

Although the results may in the end be very similar, depending largely on the way the concept of *force majeure* is understood, the interpretation of the duty of a careful constructor and the burden of proof in this respect, the two approaches fundamentally differ from each other. Therefore, an explicit choice between the two approaches has to be made.

A solution may be to distinguish between traditional contracts and 'design and build' contracts. In the latter type of contract, the constructor is able to control to a large extent the achievement of a perfect final result and it will also be much easier to establish that the defect occurred due to a circumstance that was beyond the constructor's control. On the other hand, in a traditional building contract the decisions made by the client – and, in particular, by the client's architect – may diminish the constructor's ability to achieve the perfect final result too much to put such a heavy liability on the constructor. However, with regard to the extent of control left to the constructor, probably no fundamental difference exists between a traditional building contract on the one hand and a design and build contract on the other. Certainly, the constructor's freedom is more restricted in a traditional building contract, where important decisions are usually taken by the client, whereas in a 'design and build' contract, such decisions will usually be taken by the constructor. Nevertheless, the constructor's freedom in a traditional building contract may be far greater if the client does not take these decisions, whereas the constructor's supposed freedom under a 'design and build' contract may be limited considerably by a client's interference.

Therefore, the amount of influence the client may exercise on the outcome of the construction process is not necessarily related to the choice of a modern or traditional model, but to the extent of the control of the constructor over the choices that are to be made. Making the amount of influence exercised by the other party the decisive criterion is problematic, however. It is difficult to determine the right borderline, and such a criterion would therefore lead to considerable uncertainty.

If a choice between the two systems has to be made, the fitness for purpose rule seems to be preferable. If the structure is unfit for its purpose, the constructor is generally in a much better position to explain the reasons for this than the client. Moreover, the constructor will generally be in the best position to repair the defect perceived, irrespective of who has to bear the costs in the end. Finally, in most countries insurance is available which covers the main risks of construction.

The burden on the constructor will also depend on what must be proved in order to escape liability. In this respect, the system followed here is that the constructor can be discharged by proving that the defect is caused by decisions made by the client. Such decisions may either be contained in the contract or in subsequent directions, unless the constructor had a duty to warn. In this manner, liability is linked to the extent of control the constructor has over the process. Finally, liability may be avoided if an impediment beyond the constructor's control was the cause of the non-performance, and if the constructor could not reasonably be expected to have taken the impediment into account at the time of conclusion of the contract, or to have avoided or overcome the impediment or its consequences; see III.-3:104 (Excuse due to an impediment).

This Article can be seen as an application of IV.C.-2:106 (Obligation to achieve result). For construction, the general rule is that the constructor must achieve the specific result stated by the client: 'fitness for purpose'.

It should be noted that a contract for the construction and sale of goods or other assets within the scope of Book IV.A. will be regarded as primarily a contract for the sale of those goods or assets. (IV.A.-1:102 (Goods to be manufactured or produced) The construction rules will apply only so far as necessary to regulate the construction elements in the contract and only to the extent that they do not conflict with the sales rules. (II.-1:108 (Mixed contracts)) The sales rules on conformity and remedies for non-conformity will therefore apply. This prevents conflicts between two sets of rules.

According to subparagraph (2)(a), the structure must be fit for the particular purpose made known to the constructor at the time of the conclusion of the contract or at the time the contract was changed in accordance with IV.C.-2:109 (Unilateral variation of the service contract). There is no exception, as there is in the case of sales (IV.A.-2:302 (Fitness for purpose, qualities, packaging etc.) paragraph (a)), for those situations where the client did not rely, or where it was unreasonable for the client to rely, on the

constructor's skill and judgement. In a construction case the client will normally rely, and will be entitled to rely, on the constructor having or being able to acquire the necessary skills and competence to make the structure fit for that purpose if the constructor does not make known to the client that this is not the case. In other words, if the constructor keeps silent when confronted with the particular purpose the client has for the structure, the constructor more or less guarantees that the necessary skills and competence will be available.

The national laws on construction support this solution. There, such a defence is not common. In construction situations, it will generally be less burdensome for the constructor to state expressly that the fitness of a structure for a particular purpose is not guaranteed, because the parties will communicate frequently. It is different in important categories of pure sales transactions, such as consumer transactions and trading, where the parties will not communicate so frequently.

As in the Article on sales, the present Article also refers to the normal purpose of a structure of the kind in question. In construction cases, a specific purpose will often be made known to the constructor. This may happen during the negotiations preceding the contract or at the time of later variations or directions. In the latter case, the purpose made known to the constructor will generally be a more specific one.

The burden of proof that the structure is not fit for its purpose is on the client. The client will not have much difficulty in proving communication about the structure's normal purpose. Proving that a specific purpose has been communicated to the constructor will be less easy, but it is reasonable to require this of the client. With respect to claims under paragraph (4), the burden of proof is on the constructor.

The rules in this Article are default rules. They apply only unless otherwise agreed.

IV.C.–3:105: Inspection, supervision and acceptance

(1) The client may inspect or supervise the tools and materials used in the construction process, the process of construction and the resulting structure in a reasonable manner and at any reasonable time, but is not bound to do so.

(2) If the parties agree that the constructor has to present certain elements of the tools and materials used, the process or the resulting structure to the client for acceptance, the constructor may not proceed with the construction before having been allowed by the client to do so.

(3) Absence of, or inadequate, inspection, supervision or acceptance does not relieve the constructor wholly or partially from liability. This rule also applies when the client is under a contractual obligation to inspect, supervise or accept the structure or the construction of it.

COMMENTS

A. General idea

This Article deals with the options of the client to control what the constructor does in order to perform the obligations under the contract. Reasonable supervision and inspection are allowed. The parties may agree that certain input, elements of the process, or parts of the final structure have to be presented to the client for acceptance. If they do so agree, the constructor must wait for the client's answer before proceeding with the construction.

The general approach is that all these measures are deemed to serve the interests of the client only. This means that the client has no obligation or duty to inspect or supervise. The client's failure to do so does not relieve the constructor from any obligations even if the contract provides for inspection or supervision. A provision that certain matters must be accepted by the client before the constructor can proceed is also seen as an extra check for the client. The constructor's position is, however, protected to some extent by the rules on failure to notify in III.-3:107 (Failure to notify non-conformity).

Illustration 1

The client of a provider of tailor-made machinery for a production facility is entitled to supervise and inspect the work of the constructor. He may also require the constructor to submit parts of the machinery for testing. If the constructor delivers machinery that is not fit for its purpose, however, he cannot defend himself by indicating that the client should have discovered the defect during an appropriate inspection or while supervising the construction process. Acceptance by the client is no defence either, because acceptance is deemed to take place in the interest of the client. The constructor may however, show that the allegedly defective performance was a result of a direction by the client, or of a variation of the contract.

B. Interests at stake and policy considerations

The client will often want to monitor the input, process and results of construction activities during construction. Inspections, or even constant supervision of the activity, may cause some disturbance to the constructor, but when well timed and organised they usually can be carried out with minimal costs to the constructor. When there are important choices to be made by the constructor, the client may want the constructor to submit the choices and ask for agreement. Similarly, the client may wish the constructor to present certain input, elements of the process or results for approval before the constructor proceeds to the next stages of construction. But what are the consequences of inspection, supervision or acceptance for the liability of the service provider?

Inspections – or supervision as a more intensive type of monitoring – are beneficial to the constructor as well. Costs may be saved by early discovery of potential defects or of

changes in preferences of the client which might have led to repair or to variations. When inspections are carried out by well-informed clients, or by experts hired by the client, the constructor will probably even take advantage of their knowledge and use it to reach superior results against lower costs. In some construction activities, the roles of the constructor and the supervisor may even be reversed. The constructor then is just the one who carries out the detailed instructions by the supervisor; the supervisor provides the expertise.

The position of the client needs careful consideration in this respect. The supervision provided or hired by the client will lead to some overlap in expertise. Both the supervisor and the constructor will, for instance, spend time considering the advantages and disadvantages of certain alternatives. This overlap is essential and intended, because the interaction will presumably lead to better results, but it also leads to extra costs. There will be a point where the doubling of expertise starts to become detrimental to the client's interests. On the other hand, situations may develop where the experts rely excessively on each other to solve a particular problem. Hiring a supervisor, for instance, may lead to the constructor's relying on the supervisor's expertise for every minor decision, which will drive up the costs of supervision and not substantially diminish the costs on the part of the constructor, whose contract may be at a fixed price. And when the constructor relies on the supervisor to solve an issue, whilst the supervisor expects the constructor to deal with it, the client may suffer in the end. The client may be confronted with a defect, and will have difficulties attributing the responsibility for this defect.

What is needed here, therefore, is a clear division of responsibilities, or at least a procedure that leads to that state of affairs. The rule adopted should prevent an unnecessary overlap of the efforts of the parties involved, but also cover situations where no party is responsible. At the same time, the rule should facilitate valuable types of co-operation between constructor, supervisor and client.

With respect to the acceptance of certain elements by the client, the situation is somewhat different. The client may want the constructor to submit choices. The constructor, on the contrary, may want to obtain the client's approval in order to be protected against future claims, especially in cases where there is uncertainty as to the quality of particular alternatives.

C. Comparative overview

In all countries, inspection or supervision is a right of the client, subject to qualifications designed to prevent unnecessary disturbance of the activities of the constructor. In no EU country is the client under a duty to inspect or supervise the construction activity regularly. In most countries supervision is very common in larger construction projects. In other countries (e.g. France and Spain), even in small construction projects an architect is likely to be in charge.

Even if the parties agreed that the client is to supervise or inspect, this is generally thought to be purely in the interest of the client. In most jurisdictions (England, Sweden, France, Italy, Germany, Austria, Portugal), the highest courts have ruled that inadequate supervision by the client is no reason to diminish the constructor's liability regarding defects, or standard conditions provide for this (Sweden). In other countries, the legal position is still unclear (Greece). In the Netherlands, case law has gone in a different direction, but this approach is heavily criticised.

D. Preferred option

The EU systems seem to agree on the position with regard to inspection and supervision. As a rule, supervision or inspection is a right of the client even if it has been explicitly agreed that it must take place. Inadequate inspection or supervision should not lead to a shift in liability for defects. This means that, under the default rule, there is no room for a shift of responsibilities from constructor to client (or the supervisor hired by the client).

In practice, the system provided by the present rules will be flexible enough to cover the situation where the client – or, more likely, the supervisor – is the more knowledgeable person and the constructor relies on this knowledge. When the constructor relies on the supervisor, and the supervisor actually takes the decisions on behalf of the client, the rules on directions will apply and will shift much of the responsibility to the client, who in turn will be able to take action against the supervisor if the supervisor acted negligently.

Illustration 2

An architect hired by a client tells the builder of a house how to construct a part of the roof. The architect provides the solution. This will count as a direction under IV.C.–2:107 (Directions of the client). The liability of the constructor will now be limited to liability under IV.C.–2:108 (Contractual obligation of the service provider to warn).

There is a difference in consequences between a direction and acceptance. Directions lead to a shift in responsibilities; acceptance – as defined in paragraph (2) as a decision during the construction process – does not. In practice, it may be very difficult to distinguish between the two situations. The constructor may even strategically use this difference and try to redirect liability in situations where that is undesirable.

Illustration 3

A constructor is uncertain which of two possible solutions for part of the roof will be better; one looks slightly more promising, but is also slightly more expensive. He puts the issue before the architect hired by the client. After some deliberation, they jointly choose one solution. The solution chosen turns out to be inferior. If this is considered to be a direction by the client, the client will have to prove that the constructor should have warned against the probable inferiority whereas if this is regarded as acceptance, the constructor will be liable for the defect.

The distinguishing criterion is which of the parties – the constructor or the client (or the client’s representative), actually made the choice. Was it the constructor who had the biggest influence on the decision? Or was it the client or the supervisor who made the choice? Sometimes it will be very difficult to reconstruct the communication that took place between the parties and to establish what each party knew at what moment in time. A guideline may be to determine which party was the most knowledgeable about the issue in question. In some cases, the courts may have to decide that it was a joint decision by people with equal knowledge. Application of III.–3:704 (Loss attributable to creditor) may then provide a solution: the constructor will not be liable for loss suffered by the client to the extent that the client contributed to the non-performance or its effects.

The rules contained in this Article are again default rules. The parties may opt for a regime according to which insufficient inspection, inadequate supervision or acceptance wholly or partially relieves the constructor from liability. As indicated above, the mere fact that the contract provides for inspection, supervision or acceptance is not sufficient to warrant such consequences. The presumption is that inspection, supervision and acceptance are agreed upon solely in the interests of the client. When a change in the distribution of risks is intended, this consequence should be contracted for explicitly.

IV.C.–3:106: Handing-over of the structure

(1) If the constructor regards the structure, or any part of it which is fit for independent use, as sufficiently completed and wishes to transfer control over it to the client, the client must accept such control within a reasonable time after being notified. The client may refuse to accept the control when the structure, or the relevant part of it, does not conform to the contract and such non-conformity makes it unfit for use.

(2) Acceptance by the client of the control over the structure does not relieve the constructor wholly or partially from liability. This rule also applies when the client is under a contractual obligation to inspect, supervise or accept the structure or the construction of it.

(3) This Article does not apply if, under the contract, control is not to be transferred to the client.

COMMENTS

A. General idea

This Article deals with the actual handing over of the structure at the time the structure is sufficiently completed. Paragraph (1) contains the idea that the constructor takes the initiative for the transfer of control and that the client is to accept control, unless there are serious defects. Minor defects and defects that can be repaired in a short period of time do not prevent the constructor from transferring control. The client may refuse control if the defects make the structure unfit for use.

The transfer of control is detached from rights related to non-performance. To that extent, paragraph (2) provides that acceptance by the client of the control over the structure may not be construed as a waiver of any rights related to non-performance. The client's position as to remedies for non-performance only becomes less strong when the client does not notify the constructor of defects within a reasonable time after becoming aware of them.

Paragraph (2) does not, however, deny the constructor the possibility of bringing to the attention of the client situations that might lead to complaints regarding the way the constructor performed.

Illustration 1

A constructor of a building wishes to transfer the control of the building to the client. He notifies the client. The client is obliged to take over control, unless the building is unfit for use. The client does not have to refuse to take over control for fear of losing rights with respect to non-performance. The present Article expressly provides that the client keeps such rights notwithstanding acceptance of control over the structure.

B. Interests at stake and policy considerations

With respect to the handing over of the structure, several issues arise which are best discussed separately. The first issue is that the constructor has an interest in transferring the control over the structure to the client because duties and liabilities connected to the safeguarding of the structure translate into costs, for instance the costs of insurance. The client has an obvious interest in obtaining control, so that the structure can be used for its purposes. The client will also need to know when control is transferred, for purposes of security and insurance. The transfer of control is a burden on the client, however, if the structure cannot yet be used for its purpose because it is not finished yet or if there are serious defects.

Another point is the right to payment. Under most contracts, and under the default rule contained in the following Article, at least a substantial part of the price will be due at the time the structure, or the control over it, is handed over. The constructor has an obvious interest in collecting the money, whereas the client may want to postpone payment in order to keep the constructor under pressure to perform or for other reasons.

When the structure is completed, it is in the constructor's interest to be informed about what else will be expected. The constructor will want to know whether the client is satisfied with the result and, if not, what the client perceives to be defects which need to be remedied. At some time, the constructor also wishes to be certain that no additional effort is expected, except perhaps the remedying of any future defects. For the client, it may also be important to bring additional wishes to the attention of the constructor. The sooner this is done, the higher the probability that the constructor will be prepared to fix

the problem without delay or extra charge. In this respect, the client will want to inspect the structure thoroughly. But the time and money that need to be invested in inspection compete with other preferences of the client. So the intensity of inspections undertaken will vary greatly across clients. The problem is similar to the ones arising in the context of monitoring before the handing over of a structure that were discussed in the Comments to the preceding Article. Early detection of problems is still important. Added to this, there is now the desire of both parties to end their co-operation and to be able to use their resources on other projects.

If not adequately inspecting the structure means that the client risks losing rights relating to non-performance, this is a powerful extra incentive for inspection. But the optimum level of inspection will be hard to determine. Because of the difficulties the courts will have in establishing what level of inspection is reasonable, some clients will inspect very thoroughly and will issue many complaints in order to cope with the resulting uncertainty. Other clients may think they have inspected sufficiently, but lose their rights because the courts decide differently. The constructor may also strategically use such rules. There may be an incentive to hide defects. Generally speaking, the constructor has superior expertise, and during the construction process will have gathered even more information regarding potential defects. If this presupposition holds, it will be more efficient to urge the constructor to disclose this information than to have the client searching for potential defects while not knowing where to look.

C. Preferred option

In the present Article, acceptance and the transfer of control are separated. Transfer of control is a part of the obligations of the constructor. The time when or within which it is to take place is determined by the contract or the general rules on time of performance. (III.-2:102 (Time of performance)). The client is to accept control within a reasonable time span after having been informed by the constructor of the latter's wish to transfer. It is the constructor who determines whether the structure is sufficiently completed in order to transfer control. In many cases, the right time to transfer control is when the structure is completed in every respect and every defect is remedied. A partly finished structure may already be very useful to the client, but the client is not obliged to accept control as long as the structure still has essential defects and cannot be used for the client's purposes. This situation is captured in paragraph (1), by referring to fitness for use. The idea is that small defects, which are more or less inevitable in large construction projects, and minor elements of the construction work which still need to be finished are no obstacle to transfer of control.

Thus, the date on which control is transferred is not necessarily the date on which the constructor has performed all the obligations under the contract. It may very well be that some elements of the performance are not yet ready.

Illustration 2

The control over a house is transferred to the client. The constructor still has to finish the painting part of the job and to construct the parking bays in front of the

building. Thus, the constructor has not yet fully performed the contractual obligations. Whether the remaining part of the obligations will be performed in time is a matter of interpretation of the contract or of application of the general rule on time of performance.

In principle, the rules for final acceptance and inspection are the same as for the intermediate ones on which the preceding Article focuses. No investigation of any kind is required. The client is just expected to be as attentive as could be expected from a comparable client in that situation. The client is not obliged to inspect the structure, not even to take a look at it. But the interests of the constructor are protected because there is the opportunity to bring elements to the attention of the client, so that the client will risk losing remedies through inaction and failure to notify.

If the client does not accept the control over the structure when bound to do so, the constructor of a corporeal movable may be able to invoke III.-2:111 (Property not accepted). In particular, the constructor may deposit the structure with a third party, or even sell it, though only after reasonable notice to the client. The rules regarding these remedies should be applied, however, taking the interests of the client into account. Usually, the client in a construction contract will have chosen the construction of a specific structure because it is not available on the market for existing goods. When the structure is sold to another person, the client will often again have to hire another person to construct the object. The costs and delay involved will generally be substantial. This has to be reflected in the appropriate means of giving notice (explicitly and in writing, in most cases) and in the reasonable time for the notice.

IV.C.-3:107: Payment of the price

(1) The price or a proportionate part of it is payable when the constructor transfers the control of the structure or a part of it to the client in accordance with the preceding Article.

(2) However, where work remains to be done under the contract on the structure or relevant part of it after such transfer the client may withhold such part of the price as is reasonable until the work is completed.

(3) If, under the contract, control is not to be transferred to the client, the price is payable when the work has been completed, the constructor has so informed the client and the client has had a chance to inspect the structure.

COMMENTS

A. General idea

This Article determines the time at which the price generally should be paid. This is the time of the transfer of control. If the transfer of control is to take place but the client does

not accept control, the price becomes payable as well; see IV.C.–3:106 (Handing over of the structure) paragraph (1), second sentence read in conjunction with the present Article.

Illustration 1

The constructor of a private road has put the road at the disposal of the client in conformity with IV.C.–3:106 (Handing over of the structure). The payment of the price is now due. The client may only refuse to pay the price if entitled to refuse to accept control under that Article, that is, if non-conformity makes the road unfit for use. If there are minor defects to be remedied the client may withhold a small part of the price under paragraph (2) until the work is done.

B. Interests at stake and policy considerations

The time of payment of the price is unproblematic if the contract is completely performed at the time of transfer of control. In construction projects, however, it is quite common for there to be some defects at the time of delivery. This may be a matter of delays in the delivery of some elements of the structure or of defects that show up in the final stage of the construction process. The system of IV.C.–3:106 (Handing over of the structure) is that these defects do not prevent the transfer of control to the client. Under this system, the structure will often not yet be completed at the time of transfer of control. This will induce the client to withhold payment partially, because the client will want the constructor to finalise the structure. The constructor, however, will feel entitled to payment because the greater part of the work has been completed and there will be some loss of power over the client when control over the structure is transferred to the client and the client starts to use it.

The general rule in the legal systems is that payment is due at the time of the transfer of control (Netherlands, Belgium, Spain and Greece) or the moment of acceptance (France, Italy, Germany, Portugal, Finland). England and Austria opt for the moment of completion of the structure.

C. Preferred option

The time of payment is certainly an issue to which the parties should give attention when drafting a construction contract. As a default rule, the moment of transfer of control is a better solution than the moment of acceptance, because there may be discussions about defects, which can be difficult to solve. The client is protected because control does not have to be accepted if the structure does not conform to the contract and such non-conformity makes it unfit for use (see the preceding Article). The solution where payment is due at the time of the transfer of control may be problematic because in most projects the client will want to withhold part of the payment if the work is not entirely finished. If the parties did not take this into account in their contract – for instance by giving the client the right to withhold 10 per cent of the price for a period of six months – the client may wish to invoke paragraph (2) and withhold such part of the price as is reasonable until the work is completed. The general provision in III.–3:401 (Right to withhold performance of reciprocal obligation) is not sufficient because, in the present situation,

the client could withhold payment only if the client reasonably believed that the constructor would not complete the work. (See paragraph (2) of that Article.)

Illustration 2

A website built for a client is not entirely free of defects at the time control is transferred to the client. The client starts using the site. According to paragraph (1) of the present Article, the client is to pay the price. Paragraph (2) however, allows the client to withhold a percentage of the price until the constructor's obligations are fully performed.

Paragraph (3) of the Article deals with the comparatively rare situation where control is not to be transferred to the client. For example, the constructor is obliged to construct a prototype just to see how easy or difficult it will be to make it. The client wants to be able to inspect the process and the result but has no interest in having the prototype handed over. For this unusual type of case the normal rule is obviously inappropriate and paragraph (3) provides that the price is payable when the work has been completed, the constructor has so informed the client and the client has had a chance to inspect the structure.

IV.C.-3:108: Risks

(1) This Article applies if the structure is destroyed or damaged due to an event which the constructor could not have avoided or overcome and the constructor cannot be held accountable for the destruction or damage.

(2) In this Article the "relevant time" is:

(a) where the control of the structure is to be transferred to the client, the time when such control has been, or should have been, transferred in accordance with IV.C.-3:106 (Handing over of the structure);

(b) in other cases, the time when the work has been completed and the constructor has so informed the client.

(3) When the situation mentioned in paragraph (1) has been caused by an event occurring before the relevant time and it is still possible to perform:

(a) the constructor still has to perform or, as the case may be, perform again;

(b) the client is only obliged to pay for the constructor's performance under (a);

(c) the time for performance is extended in accordance with paragraph (6) of IV.C.-2:109 (Unilateral variation of the service contract);

(d) the rules of III.-3:104 (Excuse due to an impediment) may apply to the constructor's original performance; and

(e) the constructor is not obliged to compensate the client for losses to materials provided by the client.

(4) When the situation mentioned in paragraph (1) has been caused by an event occurring before the relevant time, and it is no longer possible to perform:

(a) the client does not have to pay for the service rendered;

(b) the rules of III.–3:104 (Excuse due to an impediment) may apply to the constructor’s performance; and

(c) the constructor is not obliged to compensate the client for losses to materials provided by the client, but is obliged to return the structure or what remains of it to the client.

(5) When the situation mentioned in paragraph (1) has been caused by an event occurring after the relevant time:

(a) the constructor does not have to perform again; and

(b) the client remains obliged to pay the price.

COMMENTS

A. General idea

This Article deals with the liability for external causes of harm to the structure. According to IV.C.–3:104 (Conformity), the constructor is liable when the structure is not fit for its purpose (and the defect is not attributable to the client because it is caused by a direction for which no duty to warn existed). In theory, III.–3:104 (Excuse due to an impediment) could apply. But that Article requires that the impediment was outside the debtor’s sphere of control, that it could not be taken into account and that it was insurmountable. That the sphere of control of the constructor includes protecting the structure against outside harm is provided for in IV.C.–3:103 (Obligation to prevent damage to structure).

Before delivery – the transfer of control over the structure pursuant to IV.C.–3:106 (Handing over of the structure) – the risks identified in paragraphs (3) and (4) remain with the constructor, subject to the limitations in these paragraphs. After the transfer of control, the liability regime changes; the client becomes responsible for external harm (paragraph (5)).

Illustration 1

During construction, an office building is severely damaged by a storm. Assuming that the constructor has done everything that can reasonably be expected to prevent the harm, the constructor will have to rebuild the building. The time span for performance will be adjusted. Materials delivered by the client that were lost will have to be provided by the client again or paid for by the client.

B. Interests at stake and policy considerations

Nowadays, the topic of risk is only of limited practical interest. The causes for non-performance will usually be attributed to one or the other party. In construction contracts, each party will generally bear the consequences of its own choices if the outcome of the contractual co-operation is not satisfactory. Residual risk will be limited. Damage caused by natural disasters such as landslides and flooding is likely to occur less frequently in the future, because national authorities in the EU have been taking preventive measures for years. Still, the responsibility for external harm to the structure has to be distributed

over the parties. This will have to change in time. Whilst it is reasonable that the constructor bears much of the risk when in the best position to take preventive measures, there will be a time when the client has to take over responsibility.

External harm may have various consequences. One issue is whether the constructor has to do again what has already been done in performing the contractual obligations. Another issue is what happens to any materials or components provided by the client but lost due to the external harm. Is it to be supplied by the constructor or again, by the client? And what about the payment of the price by the client?

EU countries differ with respect to risk distribution in the period before the constructor has finished the structure. Some countries are more lenient to the debtor than others. This is discussed in the Notes to III.-3:104 (Excuse due to an impediment). The present Article follows the system of that Article.

With respect to materials provided by the client the general rule in most countries is that the constructor is only under a duty to guard these with the care that is appropriate in the circumstances. The natural corollary of this is that, in the case of an unfortunate event not related to non-performance of one of the duties of the constructor, the client has to supply the materials again, and still has to pay the price and is not entitled to compensation from the constructor. Such is the system in England, Sweden, the Netherlands, Belgium, France, Italy, Germany, Austria, Greece and Portugal.

There is no significant difference between the systems relating to risk distribution after the completion of the construction contract. It will be clear that prevention against external harm then is to be taken care of by the client. But the constructor remains responsible for the non-performance of obligations under the contract, which may include an obligation to make the structure resistant to particular causes of external harm.

Illustration 2

The duty to deliver a structure fit for its purpose will normally entail several measures to make it less susceptible to external harm. A building should normally be protected against rain, storm and lightning. It should not have exterior parts that are easy to remove by thieves.

The third issue the Article deals with is when the first type of distribution of responsibilities switches to the second one. In most countries, risk passes at the time the control of the structure is transferred (England, Sweden, the Netherlands, Belgium, France, Germany, Austria). In some countries ownership is decisive (Portugal).

C. Preferred option

Many events that were once considered unforeseeable or insurmountable are now within the reach of affordable preventive measures. As a consequence, the constructor will have far-reaching obligations under IV.C.-3:103 (Obligation to prevent damage to structure) to

protect the structure against the consequences of external events. But unexpected events may still occur, and the constructor is not accountable for them. Before delivery, this is dealt with by III.–3:104 (Excuse due to an impediment).

If the non-performance is not excusable under that Article, the constructor has to perform again. The constructor is then considered not to have performed yet, so the rules on non-performance apply. If the non-performance is excusable, however, the client will not have a right to specific performance or damages, and termination of the contract may be the result. The client will also have to pay the price, which may be reduced, however; see III.–3:601 (Right to reduce price). According to subparagraph (3)(c) of the current Article, the time of performance will need to be extended since the constructor, due to the unfortunate event, can no longer perform in time. The idea is that the time of performance will be extended proportionally.

The situation is different when an excusing impediment has made performance completely and permanently impossible. In that case, the obligations of both parties will be extinguished. See III.–3:104 (Excuse due to an impediment), in particular paragraph (5).

After completion of the structure, there will be a time from which the structure is no longer within the constructor's sphere of control. In the case of external harm to the structure, the constructor will still be liable for non-performance of obligations to protect the structure but is not liable if the damage cannot be traced back to non-fulfilment of one of these obligations.

With regard to the time of switching, this Article follows the system of most EU countries: the time of the transfer of control is normally decisive. In those comparatively rare cases where control is not to be transferred, the time when the work has been completed and the client has been informed of this is the relevant time.

CHAPTER 4: PROCESSING

IV.C.–4:101: Scope

(1) This Chapter applies to contracts under which one party, the processor, undertakes to perform a service on an existing movable or incorporeal thing or to an immovable structure for another party, the client. It does not, however, apply to construction work on an existing building or other immovable structure.

(2) This Chapter applies in particular to contracts under which the processor undertakes to repair, maintain or clean an existing movable or incorporeal thing or immovable structure.

COMMENTS

A. General idea

A contract for processing is defined in Annex 1 as “a contract under which one party, the processor, undertakes to perform a service on an existing movable or incorporeal thing or to an immovable structure for another party, the client (except where the service is construction work on an existing building or other immovable structure)”. This is the same, in definition form, as the rule on scope in the present Article.

Processing may be further described as the performance of a service on an existing thing, in order to effect or prevent a change in it. Usually, but not always, the objective will be an improvement in the thing or an increase in its value.

Illustration 1

A car has broken down and is repaired by a garage.

This is a simple example of work on an existing thing. A contract for such work falls clearly within the scope of this Chapter.

To enable the obligation to be performed, the thing will normally – though not necessarily – be brought into the care of the provider of the service (the processor). Like storage, processing will therefore often go together with the handing over of the thing to the provider of the service. In contrast to storage, the thing is not handed over for safeguarding, but to be worked on by the provider of the service. In performing the service, many things may go wrong, thus damaging the thing. The risk of such damage occurring is the main issue in processing contracts.

When the contract concerns the processing of immovable property, the property will of course not be handed over. The client will, however, have to hand over to the processor the control over the immovable property or part of it. This will often be done by giving access to the property. The main issue for the work on immovable property, again, is the risk of damage, in this case not only to the thing itself but also to other things located at or near the thing.

B. Interests at stake and policy considerations

The main policy issue is why some types of contracts are to be covered by the concept of processing. Contracts for work on existing things are traditionally covered by the same rules as construction contracts. However, those rules were designed to regulate the creation of a new thing instead of its alteration or maintenance and are not always very apt for dealing with the specific problems of processing. The fact that the processor takes control over the thing implies that one of the main risks to be guarded against is that the thing is damaged during the performance of the service.

C. Preferred option

The preferred option is to have separate rules for processing contracts but to give them a broad scope. So the Chapter applies to all contracts whereby a party is to perform a service on an existing thing. Paragraph (2) specifies that it applies in particular to contracts whereby the processor is to repair, maintain or clean an existing thing. The Chapter, however, also applies to modern types of services, e. g. a contract by which a software program is to be reprogrammed or a computer system is to be maintained. It also applies to purely commercial contracts, e. g. where the packaging of things produced by a client is outsourced to a professional packaging or wrapping service provider.

D. Relation to other provisions

The relation between the rules on processing and the rules on construction is a close one as the services rendered are rather similar. For this reason, the rules in the Chapters on construction and processing have been closely aligned. Nevertheless, it may be difficult to qualify a specific contract as either a processing or a construction contract.

Illustration 2

A thatcher replaces the existing roof of a cottage by new thatch. This is a rather traditional example of a contract for work on an existing thing, but its qualification is not as simple as it seems.

The replacement of an old roof of a building by a new one may be regarded as repair of the old building, in which case the service would be qualified as processing, but it may also be regarded as the building of a new thing (the new roof) on top of an existing structure (the rest of the building). In the latter case, the exchange of the roof would be qualified as construction. Even though this qualification seems to make less sense than qualification as a processing contract, construction work on existing immovable property is traditionally considered to be governed by the rules on construction. To avoid these specific qualification problems, IV.C.–3:101 (Scope) in the construction Chapter explicitly provides that the rules on construction apply, with appropriate adaptations, to contracts by which the service provider undertakes to materially alter an existing building or other immovable structure. The second sentence of paragraph (1) of the present Article excludes such cases from the present Chapter. Consequently, the rules on processing do not apply.

Under Article 2 of the Consumer Sales Directive (Directive 1999/44/EC, *OJ* 1999, L 171/12), the rules on consumer sales also apply if the seller, in addition to selling a thing, undertakes to install or assemble the thing. Under the present Chapter the installation or assembly of the thing would be considered a processing service. However, the rules on processing and sales have been closely aligned, especially with regard to the applicable remedies.

E. Scope of application of the rules

The following illustrations may provide more insight into the borderline between processing and other services.

Illustration 3

A piece of furniture is made to look antique by applying specialised techniques.

The Chapter applies. It does not matter that the service appears to be directed to producing a deterioration. A service is being performed on the item.

Illustration 4

A car has broken down and is towed to a garage.

The towing of the car does not do anything to change the condition of the car. No work is done *on* the car. This situation is not within the Chapter.

Illustration 5

A car is to be demolished.

The condition of the car will definitely be changed. Work is to be done on the car. It does not matter that the work on the car is not meant to improve or even to maintain the condition of the car. The rules on processing apply.

Illustration 6

A surveillance company supervises the building in which a factory is located.

Although the control over the building is – partly – handed over to the surveillance company, the building is not worked on by the surveillance company. Therefore, the rules on processing do not apply.

The rules of the present Chapter apply with appropriate adaptations to the processing parts of mixed contracts such as those where, in addition to a sale, processing services are rendered.

Illustration 7

A man buys a wardrobe in flat-pack form. As he is manually incompetent, the parties agree, as part of the same contract, that the seller will put the wardrobe together, in return for extra money.

The rules on processing will apply to the assembly part of the contract.

Illustration 8

A woman buys some 4 m planks from a do-it-yourself shop. She wants to use the planks to construct a small wooden shed. As part of the same contract the shop agrees to saw the planks into 2m lengths. The employee of the shop carelessly makes some of the cuts at 1.80 m.

The rules on processing will apply to the sawing part of the contract.

Illustration 9

A chimney sweep is contracted to sweep the chimney of a house.

This might be considered a borderline situation because the building as such does not change much by the work. Yet the house is to be worked on. The contract is for a type of cleaning and is covered by the rules in this Chapter.

IV.C.–4:102: Obligation of client to co-operate

The obligation to co-operate requires in particular the client to:

- (a) hand over the thing or to give the control of it to the processor, or to give access to the site where the service is to be performed in so far as may reasonably be considered necessary to enable the processor to perform the obligations under the contract; and*
- (b) in so far as they must be provided by the client, provide the components, materials and tools in time to enable the processor to perform the obligations under the contract.*

COMMENTS

A. General idea

The obligation to co-operate mentioned in the Article is the general obligation under III.–1:104 (Co-operation) as expanded for service contracts by IV.C.–2:103 (Obligation to co-operate). The client is to enable the processor to perform the service the client has asked for. This means, first, that the client must provide the processor with the thing to be worked on; and secondly, that, if the parties agreed that materials, tools or components are to be supplied by the client, they must be supplied in good time so as not to hold up the performance of the service.

Illustration 1

A car owner agrees with a garage for the car to be serviced the next day. The client is to take the car to the garage at the agreed time and place.

Illustration 2

A client is no longer able to regularly clean his house, and requests the services of a cleaning company. The parties agree that the client will provide the cleaning

materials, brooms and mops. The client is to make sure that sufficient materials and tools are available in good time.

B. Interests at stake and policy considerations

It might be argued that these rules are unnecessary - first because there are already provisions on the obligation to co-operate in other Articles (III.–1:104 (Co-operation) and IV.C.–2:103 (Obligation to co-operate)) and secondly because meeting these requirements clearly is in the client's own interest. Performance will be held up until the client does meet them. However, there is an argument for particularising aspects of the client's obligation to co-operate in relation to processing contracts. And the processor will often have an independent interest in the client meeting these requirements, as the price may have been calculated in accordance with the duration of performance and it may not be possible to use the workforce for another job. The Article takes that interest into account.

C. Preferred option

The preferred option is to include an Article making more specific certain aspects of the general obligation to co-operate so far as the *client* is concerned. The most important specification, which is particular to processing contracts, is that the client must hand over the thing or the control of it to the processor in order for the service to be performed on that thing. If immovable property is to be worked on, or if the processor is required to collect the thing, the client must give the processor access to it. In all cases, the client must perform the obligation in time to enable the processor to perform the processor's obligations under the contract.

IV.C.–4:103: Obligation to prevent damage to thing being processed

The processor must take reasonable precautions in order to prevent any damage to the thing being processed.

COMMENTS

A. General idea

A significant risk for the client is that the processor may damage the thing being worked on. The present Article contains a specification of the obligation of skill and care imposed on any service provider. See IV.C.–2:105 (Obligation of skill and care) paragraph (5). The processor must take reasonable precautions to prevent unnecessary damage to the thing being worked on, whether such damage is caused by the processor, by third parties or by other external causes. "Damage" means any type of detrimental effect: it includes loss and injury. (Annex 1).

Illustration 1

A cleaning company is contracted to clean an office building daily between 6 and 8 p. m. After having finished an individual office, the employee of the cleaning company is to lock the doors of that office in order to prevent theft.

Illustration 2

A cabinetmaker is requested to restore a precious Chinese folding screen. In the cabinetmaker's workshop, the folding screen is to be placed in such a manner that it will not be damaged by an opening door.

B. Interests at stake and policy considerations

When an existing thing is worked on, there is an almost inherent risk of damage to the thing. Because the processor will normally have control over the thing, the processor is usually in the best position to take protective measures. More generally, the processor is usually in the best position to take safety measures and measures limiting any adverse impact of the activity on property and other people. The main policy issue is the extent of the obligation on the processor. Damage is to be prevented as much as possible, but there is a limit to the protective measures the processor can be expected to take: damage cannot always be prevented, or only at very high costs. It would not be reasonable nor economic to require the processor to take all possible precautionary measures.

C. Preferred option

The preferred option is to require reasonable precautions to be taken to prevent damage occurring to the thing being worked on. See further the Comments to IV.C.–2:105 (Obligation of skill and care). Paragraph (5) of that Article imposes a general obligation to take reasonable precautions to prevent the occurrence of any damage as a consequence of the performance of the service.

The obligation under this Article may be overridden by the terms of the contract if, in particular, the contract requires damage to be caused by, or as an incidental effect of, the processing. Such may be the case if the initial infliction of damage is necessary in order to subsequently improve the thing, but may also be the actual purpose of the contract.

Illustration 3

Confidential records are handed over to be shredded.

Destruction of the records could be seen as the infliction of damage on the thing, but liability is of course excluded because that damage is intended by both parties.

Illustration 4

A table is handed over to a furniture maker to be revarnished. Prior to the application of new varnish, the old varnish is removed and the table is sandpapered.

Although the removal of the varnish and the sandpapering temporarily worsen the condition of the table, it is clear that this procedure is needed to enable the furniture maker to revarnish the table properly. There is no obligation to take any measures to prevent such temporary damage.

The processor's obligation extends to the taking of reasonable steps to prevent damage arising from external causes.

Illustration 5

A museum has Egyptian artefacts restored. The restorer is to protect the artefacts against humidity, wind and changes in temperature, and to guard them from theft by his staff or third parties.

IV.C.–4:104: Inspection and supervision

(1) If the service is to be performed at a site provided by the client, the client may inspect or supervise the tools and material used, the performance of the service and the thing on which the service is performed in a reasonable manner and at any reasonable time, but is not bound to do so.

(2) Absence of, or inadequate inspection or supervision does not relieve the processor wholly or partially from liability. This rule also applies when the client is under a contractual obligation to accept, inspect or supervise the processing of the thing.

COMMENTS

A. General idea

The client may, but is not obliged to, watch the processor executing the contract when the service is performed on the client's premises. If the client does not exercise the right to watch the performance of the service, or does so inattentively, this does not have negative consequences.

Illustration 1

A security company is requested to install a security camera system on the outside of an office building. The client is entitled to supervise the installation of the cameras. When attaching the cameras to the building, the security company accidentally uses the wrong type of screws. As a consequence, the cameras become detached and fall down damaged beyond repair.

The client's failure to notice the use of the wrong screws when supervising the installation of the cameras does not exempt the processor in whole or in part from liability.

B. Interests at stake and policy considerations

The client has an interest in inspecting the performance of the service, for during the inspection the client may notice that the processor is not fulfilling obligations under the contract. In that case, the client would be able to intervene by giving the processor a direction or by insisting on specific performance. On the other hand, conflicting interests of the processor – especially the risk of disclosure of trade secrets – and of third parties – especially the right to privacy – may be at stake.

A second issue is what is to happen if the client was entitled to inspect or supervise, but did not do so, or if the client actually did inspect or supervise, but did so inadequately. One could think that in such a case the client forfeited the right to claim damages for non-performance as the non-performance could have been noticed earlier. On the other hand, one could argue that there is no reason why the client should lose rights when, after all, it was the processor whose non-performance led to damage.

C. Preferred option

The system preferred here is that the client has no duty to inspect, and that an absence of inspection or inadequate inspection does not relieve the processor from any obligations. If the client noticed a defect and did not notify the processor within a reasonable time consequences might follow but they would follow from the failure to notify.

As the interest of the client in inspection and supervision of the performance of the service, the processor's conflicting interest concerning the risk of the disclosure of trade secrets and the interests of third parties need to be balanced, the right to inspection and supervision in processing contracts is restricted to cases where the service is performed on the client's premises.

Inspection and supervision are a mere *right* of the client. It is not considered an obligation of the client in any legal system, and it is not considered as such under this Article either. Therefore, it does not seem justified to deprive the client of any rights if the client *could* have discovered the non-performance, but in fact did not do so, for instance because the client did not inspect at all. Even inadequate inspection should not lead to such a result, for that would provide an incentive not to inspect at all.

The present Article to a large extent mirrors the similar Article in the Chapter on Construction. The Article differs from that provision in two respects. Firstly, given the weight of the processor's interests in defending trade secrets and the right of third parties (other clients of the processor) to their privacy, the right to inspection and supervision in processing contracts is restricted to cases where the service is performed on the client's premises. Secondly, a specific provision as to the presentation of elements in the process to the client for acceptance is not needed for processing contracts and has therefore been left out. Given the default character of the present Article, the parties may of course include such a provision in their contract.

IV.C.–4:105: Return of the thing processed

(1) If the processor regards the service as sufficiently completed and wishes to return the thing or the control of it to the client, the client must accept such return or control within a reasonable time after being notified. The client may refuse to accept the return or control when the thing is not fit for use in accordance with the particular purpose for which the client had the service performed, provided that such purpose was made known to the processor or that the processor otherwise has reason to know of it.

(2) The processor must return the thing or the control of it within a reasonable time after being so requested by the client.

(3) Acceptance by the client of the return of the thing or the control of it does not relieve the processor wholly or partially from liability for non-performance.

(4) If, by virtue of the rules on the acquisition of property, the processor has become the owner of the thing, or a share in it, as a consequence of the performance of the obligations under the contract, the processor must transfer ownership of the thing or share when the thing is returned.

COMMENTS

A. General idea

This Article deals with the return of the thing or the control of it to the client. Firstly, when the processor has completed the service – and, if need be, has informed the client – the client must enable the processor to return the thing.

Illustration 1

A garage owner has repaired a car. When the repair is completed, the garage owner rings the client informing him that the car is ready. The client is to go to the garage and collect the car.

However, the client is not required to accept the return of the thing if it becomes clear that the service was not rendered correctly and the defects are so serious that the client would be entitled to terminate the contractual relationship for fundamental non-performance.

Illustration 2

A handyman has repaired a washing machine. When the handyman delivers the washing machine at the client's house and does a final test run, the washing machine does not function at all. As this clearly constitutes a fundamental non-performance, the client may refuse the return of the washing machine.

Equally, the client may request the return of the thing at any time. If the client orders the return of the thing before the service has been performed, this may amount to a

termination of the contractual relationship under IV.C.–2:111 (Client’s right to terminate), which means that the processor is still entitled to receive the price for the service.

Illustration 3

Arthur is the owner of a sophisticated mobile radio, with which supposedly transmissions from all over the world can be received. At some point, only the FM wave functions. So Arthur takes the radio to the shop for repair. One week later, the Olympics start. Arthur, a sports fan, demands the return of the radio, even though the repair has not yet taken place. The radio is to be returned, yet Arthur remains obliged to pay the price for the service that was requested.

Where, in the course of the performance of the service the processor has become the owner of the thing, the processor must return ownership of the thing to the client together with the thing itself.

B. Interests at stake and policy considerations

The processor who has possession of the thing must take proper care of it and prevent it from being damaged. The processor therefore has an interest in being freed from these obligations when the service is finished. The client may want the thing returned, either after being told about completion of the service or before it is performed. The present Article deals with these interests, as well as with the consequences of the return of the thing: does acceptance of the return of the thing imply acceptance of any defects in the service or damage to the thing?

A different problem may arise if the processing has resulted in the processor becoming the owner of the thing or a share in it. The present Article must remedy that when the thing is returned to the client.

C. Preferred option

As the processor may have an interest in being freed from the obligation to take proper care of the thing once the service has been rendered, the present Article introduces an obligation of the client to accept the return of the thing. However, as the client is not to refuse the return of the thing (unless in the case of fundamental non-performance), mere acceptance of the thing implies nothing more than that the client performs this obligation. In other words, the mere acceptance of the thing should not be interpreted as acceptance of a non-reported defect. Moreover, in processing contracts, especially when a movable has been worked on at the premises of the processor, packaging of the thing in order to enable safe transportation is not uncommon. In such circumstances, there does not seem to be a compelling reason to oblige the client to inspect the thing immediately or at the processor’s premises when it is returned to the client.

Where performance of the contractual obligations led to the transfer of ownership, that transfer is to be undone when the thing is returned to the client. To that extent, the present

Article introduces an obligation on the processor to accomplish also a retransfer of ownership. The provision, of course, only applies if ownership did in fact pass. Whether such is the case, is a matter for the Book on the Transfer of Movables.

The present Article is the functional equivalent of the Article on the handing over of the structure in the Chapter on Construction and the Article on the return of the thing in the Chapter on Storage. In this respect, these Chapters have in common that they all primarily deal with tangible things that are in the possession of a service provider and need to be transferred to the client. The Articles mentioned serve to facilitate such transfer.

Occasionally, the law of property may mean that the processor becomes owner or part owner of the thing. When the thing is returned, ownership of the thing or share must be returned free from rights of third parties that did not exist when the thing was handed over to the processor.

IV.C.-4:106: Payment of the price

(1) The price is payable when the processor transfers the thing or the control of it to the client in accordance with IV.C.-4:105 (Return of the thing processed) or the client, without being entitled to do so, refuses to accept the return of the thing.

(2) However, where work remains to be done under the contract on the thing after such transfer or refusal the client may withhold such part of the price as is reasonable until the work is completed.

(3) If, under the contract, the thing or the control of it is not to be transferred to the client, the price is payable when the work has been completed and the processor has so informed the client.

COMMENTS

A. General idea

The central question in this Article is when the client has to pay for the service rendered or to be rendered. The normal rule under the Article is that this is when the processor has performed the service and returns the thing to the client.

Illustration 1

An electrician has repaired a client's electrical appliance. Upon return of the appliance, the client is to pay the agreed price.

The client is not to frustrate the processor's right to payment by unjustifiably refusing the return of the thing. The client may, however, refuse the return of the thing if the service clearly has not been performed properly.

Illustration 2

When the electrician returns the appliance, electric wires are sticking out of it on all sides. Obviously, it has been repaired very sloppily. The client need not accept the return of the thing and therefore does not yet have to pay the price for the service rendered.

Illustration 3

A washing machine has been repaired by an engineer. When the engineer delivers the washing machine at the client's house and does a final test run, the washing machine does not function at all. The client may refuse the return of the washing machine and does not yet have to pay the price for the service.

B. Interests at stake and policy considerations

Under Book III the normal rule is that when obligations can be performed simultaneously the parties are bound to perform simultaneously. (III.–2:104 (Order of performance)) In processing contracts, however, performance of the processor's obligation will normally take some time. This implies that normally the parties cannot perform simultaneously. The party who is required to perform first therefore runs the risk of performing without having any certainty about the other party's intention to perform the reciprocal obligations. A choice has to be made whether the uncertainty is to be placed on the processor or on the client.

In most countries the normal situation is that, unless the parties have agreed otherwise, the client is obliged to pay when the service is completed and the thing is returned; in practice, this means that the processor's obligation to return the thing is performed simultaneously with the client's obligation to pay. In a few countries the client is even allowed a reasonable period to examine the thing after its delivery before having to pay.

C. Preferred option

In processing contracts, usually the service is provided before the processor requests payment, although it is not uncommon that the order is reversed. In the present Article, the general trend is followed, stating – by way of a default rule – that the client is only obliged to pay when the service has been completed, either because the processor so notifies to the client or because the client requests the return of the thing. However, the client is to be prevented from frustrating the coming into being of his obligation to pay by failing to accept the return of the thing. Therefore, the present Article sets out that the processor is also entitled to the remuneration if the client unjustly refuses to accept the return of the thing, i.e. when the processor did not deliver a fundamental non-performance.

One consequence of the rule in paragraph (1) is that the price may have to be paid even when minor defects remain to be corrected. In such a situation the client is entitled under paragraph (2) to withhold a reasonable amount until the work is completed.

Paragraph (3) deals with the situation where there is to be no return of the thing, or control over it, to the client. This will be the case where the work, such as cleaning work on a building, is done on premises or on a site under the client's control at all times. In such a case the price is payable when the work is completed.

A processing contract may be a long-term contract. This is especially true for maintenance contracts. In such a contract, which may be concluded for a definite or an indefinite period of time, it is common for the parties to agree upon payments during the performance of the contractual obligations, for instance before or after a specific period has started or ended. A specific provision to this extent is not deemed necessary here, as parties will agree upon such payments when needed.

IV.C.-4:107: Risks

(1) This Article applies if the thing is destroyed or damaged due to an event which the processor could not have avoided or overcome and the processor cannot be held accountable for the destruction or damage.

(2) If, prior to the event mentioned in paragraph (1), the processor had indicated that the processor regarded the service as sufficiently completed and that the processor wished to return the thing or the control of it to the client:

- (a) the processor is not required to perform again; and*
- (b) the client must pay the price.*

The price is due when the processor returns the remains of the thing, if any, or the client indicates that the client does not want the remains. In the latter case, the processor may dispose of the remains at the client's expense. This provision does not apply if the client was entitled to refuse the return of the thing under paragraph (1) of IV.C.-4:105 (Return of the thing processed).

(3) If the parties had agreed that the processor would be paid for each period which has elapsed, the client is obliged to pay the price for each period which has elapsed before the event mentioned in paragraph (1) occurred.

(4) If, after the event mentioned in paragraph (1), performance of the obligations under the contract is still possible for the processor:

- (a) the processor still has to perform or, as the case may be, perform again;*
- (b) the client is only obliged to pay for the processor's performance under (a); the processor's entitlement to a price under paragraph (3) is not affected by this provision;*
- (c) the client is obliged to compensate the processor for the costs the processor has to incur in order to acquire materials replacing the materials supplied by the client, unless the client on being so requested by the processor supplies these materials; and*
- (d) if need be, the time for performance is extended in accordance with paragraph (6) of IV.C.-2:109 (Unilateral variation of the service contract).*

This paragraph is without prejudice to the client's right to terminate the contractual relationship under IV.C.-2:111 (Client's right to terminate).

(5) If, in the situation mentioned in paragraph (1), performance of the obligations under the contract is no longer possible for the processor:

(a) the client does not have to pay for the service rendered; the processor's entitlement to a price under paragraph (3) is not affected by this provision; and

(b) the processor is obliged to return to the client the thing and the materials supplied by the client or what remains of them, unless the client indicates that the client does not want the remains. In the latter case, the processor may dispose of the remains at the client's expense.

COMMENTS

A. General idea

Sometimes the thing handed over to be worked on is damaged or destroyed without any fault or other cause attributable to either the client or the processor. In this case, the damage to or destruction of the thing is to be borne by the client. It is, however, unclear whether the client still has to pay for the service.

In this Article, a distinction is made between the situation where the processor had already informed the client that service was completed and the situation where that had not yet been done. In the former situation, the client bears the consequences of the unfortunate event, and must still pay the price for the service rendered, even though the benefits can no longer be enjoyed.

Illustration 1

A DVD player is being repaired. When the job is completed, the processor informs the client by phone. Before the DVD player is collected, the processor's workshop is struck by lightning; in the subsequent fire, the DVD player is damaged. The processor is not required to try to repair the DVD player again. The client, however, is required to pay the price for the service rendered.

In the latter situation, a further distinction is to be made, viz. whether performance of the service is still possible or not. If performance is still possible, the processor must still perform; if the service had already been completed but the client had not yet been so informed the processor has to perform again. The processor will be paid only for this performance. Extra costs resulting from performance after the unfortunate event must be compensated for by the client, and if the processor needs extra time to be able to perform the service, an extension of the time originally agreed upon for the performance is to be allowed.

Illustration 2

A DVD player is repaired by a processor. Before the processor has had time to inform the client, a fire breaks out. Because of water damage, the DVD player no longer works, but the processor can repair the machine. The processor is required to do so, and only receives payment for the second repair.

If performance is no longer possible, the processor is not entitled to payment, and must return the thing or what remains of it to the client if the client gives notice of a wish to receive the thing or what remains of it.

Illustration 3

The DVD player is damaged so severely by the fire that repair is no longer possible. In this case, the processor is to return the remains of the DVD player to the client if the client so wishes, but does not have the right to payment.

A specific situation exists in the case of a long-term processing contract. In such a contract, the parties will often have agreed upon payment per period. The client is still required to pay for the periods that have ended, even if future performance is no longer possible.

Illustration 4

A company renders daily cleaning services. When the building where the service is performed has collapsed as a result of an earthquake, further performance is no longer possible. The cleaning services that have been rendered before the building's collapse are still to be paid for by the client.

B. Interests at stake and policy considerations

Nowadays, the topic of risk is of only limited practical interest. The causes for non-performance will mostly be attributed to one or the other party. Residual risk will be limited. Damage caused by natural disasters like landslides or flooding, for instance, will occur less frequently, because processors will have taken precautionary measures – failure to do so when such measures should have been taken implies non-performance by the processor – and public authorities will have taken preventive measures as well. Yet, where such damage does occur and no duty of care or other obligation on the processor was breached, the question needs to be answered who should bear the consequences of the unfortunate destruction or deterioration of either the thing that was worked on or the materials supplied by the client. In this respect, the question also arises whether the processor may still claim performance of the client's obligation to pay the price when the thing has been destroyed or damaged due to an accident for which the processor cannot be held liable.

C. Preferred option

If such an unfortunate event occurs before the processor has indicated to the client that the service has been completed and that the thing is ready to be returned to the client, the consequences of the occurrence of the unfortunate event are dealt with by III. – 3:104 (Excuse due to an impediment). If the non-performance is not excusable under that Article, the processor has to perform again if that is still possible. The processor is then considered not to have performed yet: so the rules on non-performance apply. If the non-performance is excusable, however, the client will not have the right to specific performance or damages, and termination of the contractual relationship may be the

result. The client will also have to pay the price. According to subparagraph (4)(d) of the current Article, the time needed for performance will have to be extended, since the processor, due to the unfortunate event, can no longer perform in time. The idea is that the time for performance will be extended proportionally. The situation is different when performance has become impossible. Then, termination may be the optimal solution.

After completion of the service, the situation changes, provided that the processor has notified the client that the service has been completed and that the thing is ready to be returned to the client. In the case of external harm to the thing, the processor is still liable for non-performance of the processor's obligations; see paragraph (1). The processor is not liable, however, if the damage cannot be traced back to non-performance of one of the processor's obligations. In other words, in accordance with case law and legal doctrine throughout Europe, the risk of unfortunate destruction or deterioration of the thing or the material supplied by the client is on the client. The same applies if the client had notified the processor that the client wished the thing to be returned, but had not yet collected it. The reason for this is that the only reason why the processor still had the thing is that the client had not yet collected it. In both cases, it is deemed to be fair that the client bears the consequences of failure to collect the thing.

The subject of the present Article is the same as that of the articles on risk in the Chapters on construction and storage. However, unlike the situation under a construction contract, but as in the situation under a storage contract, the client is the owner of the thing and of the materials supplied by the client. So the situation where the risk is completely on the processor does not occur in processing contracts. Moreover, as to the transfer of the risk a slightly different moment is chosen: whereas the moment of the transfer of control is normally decisive in a construction contract, in the present Chapter the decisive moment is when the processor notifies the client that the processor regards the service as sufficiently completed and wishes to return the thing or the control of it to the client. The reason for this is that, as from that moment, it is up to the client as owner to prevent the accidental destruction or damage by simply performing the obligation to accept the return of the thing. The outcome is different only if the client was entitled to refuse the return of the thing under IV.C.–4:105 (Return of the thing processed) paragraph (1).

Paragraph (3) deals with the situation in which the parties have agreed upon payment per period that has elapsed. Such payments will normally be agreed upon in the case of processing contracts concluded for an indefinite period of time, *e. g.* maintenance contracts, but may also be agreed upon in other contracts that need a considerable period of time before completion. The paragraph provides that a price which has become due remains due, irrespective of whether performance is still possible (paragraph (4)) or not (paragraph (5)).

Paragraph (4) sets out that when performance is still possible, the processor is required to perform – or perform again. The processor is entitled to payment only for the new performance. However, the final sentence of the paragraph makes clear that if further performance has become of no use to the client, the client may terminate the contractual

relationship. In that case, the consequences as to the price will be dealt with under IV.C.–2:111 (Client’s right to terminate). Clearly, this provision does not apply if, prior to the unfortunate event, the processor had notified the client that the processor regarded the service as sufficiently completed and wished to return the thing to the client. As paragraph (2) states, in this particular case the processor does not have to perform again, but the client still must pay the price for the service rendered. Paragraph (5), finally, provides that if performance is not or no longer possible, the processor is not required to complete performance and the client does not have to pay the price for the service that did not lead to a positive outcome. Paragraphs (4) and (5) therefore impose the so-called *Preisgefahr*, i.e. who has to suffer the financial consequences in the case of an unfortunate event, on the processor. The processor, however, may – by demanding payment per period – burden the client with that risk.

It will be for the processor to prove the unfortunate nature of the event which has caused the destruction or deterioration of the thing or the materials supplied by the client in order to escape liability. The processor will further have to prove entitlement to the price or a part of it.

This parties may, of course, modify the rules in this Article.

IV.C.–4:108: Limitation of liability

In a contract between two businesses, a term restricting the processor’s liability for non-performance to the value of the thing, had the service been performed correctly, is presumed to be fair for the purposes of II.–9:406 (Meaning of “unfair” in contracts between businesses) except to the extent that it restricts liability for damage caused intentionally or by way of grossly negligent behaviour on the part of the processor or any person for whose actions the processor is responsible.

COMMENTS

A. General idea

The present Article creates a relatively safe haven for a specific type of limitation clause in processing contracts. If in a contract between two businesses the processor’s liability is limited to the value of the thing before the service is performed, that clause is presumed to be fair for the purposes of the rules on unfair contract terms (II.–9:406 (Meaning of unfair in contracts between businesses)). Only to the extent that the clause restricts liability for damage caused intentionally or by grossly negligent behaviour – i.e. such reckless behaviour that it is tantamount to intentional infliction of damage – does the presumption not hold true.

Illustration 1

A mechanic repairs the tyre of a car, owned by a lease company. The mechanic forgets to bolt the wheel on the car properly. As a result, the wheel comes off at a bend and the car hits a tree. The driver is not hurt, but the car is a complete write-off. Furthermore, the lease company is held liable by the municipality which owns the tree. The lease company claims damages, but is confronted with a standard term limiting damages to the amount of the value of the car at the time the car was repaired.

Under the present Article, as both the garage owner and the lease company act in the course of their business, the limitation clause is presumed to be fair. Had the client been a private individual, or had the garage owner acted intentionally or had the damage been caused by way of grossly negligent behaviour of the mechanic, the presumption would not have applied, and the limitation clause would have to be tested against II.-9:406 (Meaning of unfair in contracts between businesses).

B. Interests at stake and policy considerations

The main question is whether this Chapter should contain a specification of the general provisions on unfair contract terms, indicating that certain clauses are deemed or presumed to be fair in a processing contract. A further question would be whether such a clause should also be upheld in a relation to damage caused intentionally or by grossly negligent conduct. It could be argued that such specification would be helpful. On the other hand, it could be said that it would take away the flexibility of the general rules. Moreover, one could argue that a rule for processing contracts is more acceptable in commercial contracts than in consumer cases.

C. Preferred option

The legal systems at present are divided as to the acceptability of limitation clauses. In this Chapter, an intermediate solution is found by the introduction of so-called safe havens for commercial processing contracts. In such contracts, a clause restricting the processor's liability for non-performance to the value of the thing had the service been performed correctly, is *presumed* to be fair. The presumption, however, does not apply in relation to damage caused intentionally or by grossly negligent conduct. In this respect, it is remarked that even though it can be argued that a clause excluding or limiting liability may sometimes be fair and needed, it cannot be argued convincingly that a clause limiting or excluding liability even in those cases should *always* or even *normally* be considered to be fair. Therefore, clauses excluding liability for damage caused intentionally or by way of grossly negligent conduct need to be excluded from the present Article.

The client may prove that, despite the presumption in this Article, in the particular case the clause cannot be considered fair. This will be difficult, as the Article aims at providing practice with hard and fast rules for one of the most important types of exclusion or limitation clauses in processing contracts. That goal cannot be achieved if proof of the opposite is easily accepted.

The presumption applies only in *commercial* cases. In consumer cases, the damage inflicted by non-performance on the part of the processor is normally fairly limited. Usually, both the extent of the damage and the risk of its occurrence are not so extreme that that this cannot be borne by the processor. There is, therefore, insufficient reason to introduce a safe haven for consumer cases. This does not mean that a clause limiting liability in a consumer case cannot be accepted; whether the clause is valid is to be determined in accordance with the general rules on unfair contract terms as they apply to consumer contracts.

The present Article is also related to III.-3:105 (Term excluding or restricting remedies). According to that provision it may be contrary to good faith and fair dealing to invoke a contractual exclusion or restriction of a remedy. In so far as a clause is valid under the present Article, its application may be blocked by III.-3:105 if, under the specific circumstances of the case, it would be contrary to good faith and fair dealing to invoke it.

The present Article is similar to equivalent articles in the chapters on storage and design.

CHAPTER 5: STORAGE

IV.C.–5:101: Scope

(1) This Chapter applies to contracts under which one party, the storer, undertakes to store a movable or incorporeal thing for another party, the client.

(2) This Chapter does not apply to the storage of:

(a) immovable structures;

(b) movable or incorporeal things during transportation; and

(c) money or securities (except in the circumstances mentioned in paragraph (7) of IV.C.–5:110 (Liability of the hotel-keeper)) or rights.

COMMENTS

A. General idea

A contract for storage is defined in Annex 1 as “a contract under which one party, the storer, undertakes to store a movable or incorporeal thing for another party, the client”. This, in definition form, is the same in substance as the scope provision in paragraph (1) of the present Article. Three exclusions from the scope of the Chapter are listed in paragraph (2).

Storage takes place when a person (the client) places things elsewhere and leaves them in the care of somebody else (the storer) to be kept or stored, generally with a view to later use or disposal. Storage is characterised by the fact that the client hands over things to the storer, with the mutual intention of the parties to ultimately have the things returned to the client.

Illustration 1

A client hands over 1,500 oranges to be stored at a warehouse.

This is the ‘classical’ example of storage. Of course it falls within the scope of this Chapter.

In a storage contract the storer only needs to make sure the thing can ultimately be returned to the client in the same condition as it was in when it was handed over to the storer, or in such a condition as the client could reasonably expect the thing to be in when returned. When the storer does not properly store the thing, the client runs the risk that the thing is damaged during storage.

This Article describes the scope of application of the Chapter. It mainly applies to the storage of *movable* things. However, as it is possible to store other things, such as information on a computer server, the scope of application of the Chapter is not limited to

purely physical things, as is clarified by the reference to incorporeal things in paragraph (1). Where, apart from storage, another service is rendered, the provisions in Book II on mixed contracts (II.–1:108 (Mixed contracts)) ensure that the rules of the present Chapter apply to the part of the contract that involves storage, but these rules may be modified so as not to conflict with the rules governing the other service.

Illustration 2

An Internet service provider (ISP) offers its clients access to the Internet, e-mail facilities and the possibility of storing files on its server.

The present Chapter applies to the storage of files on the ISP's server, but the rules of the present Chapter may be adapted to accommodate the fact that other services are offered too.

B. Interests at stake and policy considerations

The main policy issue is whether a contract of storage can be concluded consensually or only by the actual handing over of the thing. The latter approach is in accordance with the Roman-law background of the storage contract and relates to the second main issue to be dealt with: traditionally, storage was a gratuitous contract. As the storer was not to receive any benefit from the contract, a strict rule on constitution was justified. Before the storer came under a legal obligation, there had to be not only a promise to care for the thing but also actual acceptance of it being handed over. However, such a formal way of concluding storage contracts is somewhat problematic in a commercial setting, where the client has an interest in being able to demand that the thing be taken into the storer's custody. As a consequence, it seems better to accept a more flexible way of concluding storage contracts, at least if the traditional concept of storage as a gratuitous contract is abandoned.

Another traditionally important issue to be decided is whether this Chapter should apply to gratuitous storage, to storage for a price or to both and whether, if the latter option is chosen, specific rules are needed to accommodate the fact that both gratuitous and remunerated contracts are governed by the storage rules, e. g. more stringent rules if the contract is for a price, or more lenient rules if the contract is to be performed by the storer for nothing.

A third issue is whether the rules on storage should apply to all things or only to some. For the storage of particular types of things, notably money, securities and rights, legislatures have developed specific rules. Should the present Chapter govern the storage of these types of things or should the existing specific rules be upheld? Similarly, international treaties deal with things being stored in the course of the performance of a transportation contract. Does this mean that storage in combination with transportation should be left outside the scope of the present Chapter? Finally, there is the question whether so-called surveillance contracts – in which immovable property is guarded or otherwise taken into the care of a professional service provider – should be governed by these rules or, alternatively, be subject only to Chapter I (General Provisions).

A difficult question is whether the Chapter should apply to contracts by which a client parks a car in a privately owned car park. Is the client storing the car or simply renting a space?

Another question is whether the Chapter should apply to contracts by which a client hands over things to be stored in a safety deposit box. An argument against qualification as a storage contract would be that the service provider does not know what is being taken into custody. Therefore, the service provider cannot take specific precautionary measures to prevent damage to the thing. General precautionary measures, such as to prevent theft and fire, can be taken. The service provider can guarantee that the safety deposit box will be returned in the state in which it was received it and that nobody has opened it in the meantime. However, that does not necessarily qualify the contract as a storage contract: a landlord, or lessor may also be under an obligation to take such measures.

C. Preferred option

The requirement of the actual handing over of the thing is no longer needed and is not in line with the developments in the newer civil codes nor with the needs of commercial practice. The present Chapter therefore accepts consensus as the method of conclusion of the contract.

As is the general approach to gratuitous services, this Chapter applies not only to commercial and remunerated contracts, but also – albeit with appropriate modifications – to gratuitous storage contracts. In practice, this means that the gratuitous nature of the service may be taken into account when determining whether or not the storer is liable, as the fact that storage is provided free of charge may influence the extent of care that may be expected from the storer, and the reasonable expectations of the client as to the condition in which the thing will be returned.

Illustration 3

The owner of a yacht has it stored during winter. In spring, he finds out that the yacht is stolen. If the service is performed gratuitously, the storer's obligation to exercise due care does not include the obligation to have the place of storage guarded, whereas such an obligation may exist if storage was not gratuitous.

Storage during actual transportation is usually provided for in treaties and special laws on transportation contracts. Specific legislation also exists for the storage of money, securities and rights. Such storage is excluded from the scope of application of the present Chapter in order to prevent interference with these treaties and specific legislation, which are adapted to the needs of these atypical kinds of storage. However, an exception is made if money or securities are handed over for storage in a hotel safe.

This Chapter also does not apply to the storage of immovable things as this type of storage is of a different nature, e. g. the thing is not stored at the storer's place of business, but remains on site. As the rules in this Chapter are not aimed at taking the specificities of such contracts into account and storage of immovable property is not recognized in Belgium, Germany, Poland and Spain, the scope of this Chapter does not cover the 'storage' of immovable property. The rules on service contracts in general will apply to such contracts. Of course, the exclusion of the applicability of the present Chapter to such contracts does not stand in the way of analogous application.

As to the applicability of the present Chapter to the 'storage' of cars parked in a car park, a dividing line may be drawn where the car park is, in some manner, guarded. When such is the case, the contract is to be considered a storage contract, as the operator of the car park is in a position to prevent damage to the car and to take precautionary measures.

Illustration 4

A client parks his car in a multi-storey car park, which is secured at both the exit and the entrance with a barrier; the exit barrier only opens when the client produces the ticket he received at the entrance and has paid the price for the use of the car park. The contract concluded by the parties is a storage contract.

Illustration 5

A client parks his car in a privately owned car park. The price for the use of the car park is to be paid when entering the car park. As is clear before the client enters the car park, there is no check whatsoever whether the person leaving with a car is the same as the person who entered with the car. The contract concluded by the parties is not a storage contract.

The present Chapter applies when a client hands over things to be stored in a safety deposit box. It does not matter that the storer cannot take specific precautionary measures to prevent damage to the thing as its nature is not known: general precautionary measures, for instance to prevent theft and fire can be taken. Moreover, in the case of the storage of sealed things, the storer does not know what the container stored contains either; nevertheless, such a contract is generally seen as a contract for storage. That being the case, there is no convincing reason why the contract to make use of a safety deposit box should not be considered storage. The fact that the storer does not know what is being kept of course influences what the client may expect under the contract and, therefore, influences the extent of the storer's obligations under this Chapter.

Illustration 6

A client has a sixteenth-century painting stored in a large safety deposit box. As the storer does not know that he is storing such a painting, he cannot be required to use specific installations rendering a stable temperature and humidity level. However, the storer can be expected to prevent theft from the safe by, e. g., providing a closed-camera circuit.

The Chapter contains special rules for hotel-keepers, to acknowledge the fact that the 1962 Convention on the Liability of Hotel-Keepers concerning the Property of their Guests and national legislatures implementing the Convention regulate the matter specifically.

The Chapter may apply even where the storage contract constitutes only a minor part of the whole relationship between the parties.

Illustration 7

A client hands over his coat at the guarded cloakroom of a theatre.

If the safekeeping of the coat is seen as a separate contract the rules of this Chapter apply. Even if the theatre's obligation as to the storage of the coat could be seen as a mere additional obligation under the contract entitling the client to attend a play at the theatre, the rules of this Chapter apply to some extent to the storage of the coat. See below on mixed contracts.

The Chapter applies to the storage of animals, but it is clear that such contracts will usually entail more obligations for the storer than is normally the case in a storage contract. Some such contracts may be a mixture of storage and maintenance or processing.

Storage for commercial purposes is often combined with other activities, for instance stock administration, combining things into parcels destined to go to one client, packaging things and the like. And the performance of another service, e. g. processing, may involve storage. The question arises whether the rules on storage should also apply when these other services are the primary object of the contract, i.e. when storage of the thing may be seen as merely a prerequisite to the fulfilment of the main obligation under the contract (for instance, an obligation to process or transport the thing). The preferred option in many countries (Austria, Belgium, England, France, Germany, the Netherlands and Spain, and probably also in Italy and Portugal) is to apply the storage rules to the storage part of the contract with appropriate modifications. This is also the solution adopted under the rules on mixed contracts in II.-1:108. However, in any case where the storage element is manifestly only an incidental element of a contract which is primarily of another kind, the storage rules will apply only so far as necessary to regulate the storage element and only so far as they do not conflict with the rules applicable to the dominant part of the contract. Mandatory rules applicable to the dominant part will apply. See II.-1:108 (Mixed contracts) paragraph (2).

Illustration 8

A computer repairer is to repair the software on a computer and needs to save the computer files on the hard disk temporarily on a durable medium.

This Chapter applies with appropriate modifications to the storage of the computer files. This implies that the durable medium used must be fit to return the files in the same condition as they were in when they were moved from the computer.

IV.C.–5:102: Storage place and subcontractors

(1) The storer, in so far as the storer provides the storage place, must provide a place fit for storing the thing in such a manner that the thing can be returned in the condition the client may expect.

(2) The storer may not subcontract the performance of the service without the client's consent.

COMMENTS

A. General idea

The fact that the storer takes control over the thing implies the main risk involved in the performance of the service on behalf of the client: the risk that the thing is damaged in storage. The rules in this Chapter aim at minimising that risk by imposing quality standards on the storer. This is especially important as regards the place of storage. The present Article deals specifically with the latter aspect. It states that when the storer provides the location for storage – which normally is the case – that location must be safe for storage of the thing. The Article indicates what may be expected of the storer in the process of the performance of the service. The Article is also in the storer's interests, as it provides guidance as to what is expected in order to prevent liability.

Illustration 1

A client wants to have cocoa beans stored. The storer must make sure that the location where the cocoa beans are stored is suitable for such storage taking account of such factors as the level of humidity and the temperature. If necessary, in order to perform the service correctly, the storer must see to it that the location is adjusted to enable safe storage.

The Article further states that the storer (or the storer's staff) must perform the contractual obligations without subcontracting; in other words, performance cannot be left to a third party, unless the client has agreed to such substorage.

Illustration 2

As the storer's warehouses are fully packed, the storer cannot properly store the cocoa beans he has agreed to store. The storer wants to have the storage done by a competing firm, whose services he commonly makes use of when he lacks storage capacity. Such substorage is allowed only if the client consents to it.

B. Interests at stake and policy considerations

The main issue is whether this Article is necessary. It is logical to require the storer to provide a safe location for storage. On the other hand, as long as the storer is able to return the thing in the condition the client may reasonably expect it to be, there does not seem to be much reason to burden the storer with yet another obligation. It could therefore be argued that such an obligation should not be imposed upon the storer.

A different issue is whether substorage should be allowed in the case of a storage contract. For storage, there are three reasons why subcontracting without the client's consent perhaps should not be allowed. Traditionally, a storage contract is said to be based on a relation of trust between the parties, leading to the personal nature of such a contract. It should be noted that this argument has lost most of its importance over the years, as even in non-commercial storage a fiduciary relationship is only occasionally needed: whether patient records are stored by one storer or by another is of hardly any relevance as long as the patient's privacy and the confidentiality of the records are safeguarded. A more relevant objection to allowing substorage is that the client may have a need to know where the thing is actually stored, for instance to be able to get it back fast ('just-in-time-deliveries'). Finally, the client's insurance may not cover substorage. One could argue, however, that an exception should be made for 'emergency cases', as substorage then is in the client's best interests because the thing would otherwise be damaged or destroyed.

C. Comparative overview

Case law in England and the Netherlands explicitly states that the storer is required to provide a location which is fit for the proper storage of the thing. In other legal systems, an obligation to that extent is considered to be implied; failure to provide such a location will lead to damages for failure to return the thing in accordance with the client's reasonable expectations as to its condition.

In most legal systems, substorage is traditionally permitted only with the client's consent, as it is thought that the contract requires the client's trust in the *person* of the storer. Nevertheless, a minority view in these systems holds that personal considerations are no longer so important, especially not in the case of storage by a professional party; this view therefore denies that substorage without the client's consent should be prevented.

A problem may arise if, in the case of an emergency, the storer is required to have the thing temporarily stored elsewhere and there is no time to contact the client. In some countries, notably Spain and the Netherlands, substorage is allowed in such a case without the client's consent.

D. Preferred option

Given the importance of a location suited for the storage of the thing, an obligation to provide such a location is needed. The advantage of such an obligation is that the client, instead of having to wait for the return of the thing or having to demand adequate

assurance of performance, may simply claim specific performance of the obligation on learning that the thing is not stored in a location suited for its storage.

Substorage without the client's consent should not be allowed. The traditional idea that a storage contract is of a personal nature is no longer a convincing argument. Nowadays, the main reasons for not allowing substorage by way of a default rule are the fact that the client's insurance may not cover substorage, and the practice of 'just-in-time deliveries', which require the client to be able to demand the immediate return of the thing. This practice applies especially to modern commercial storage contracts where stocks are often kept to a minimum in order to cut down on expenses. In such a case, the client may need to have direct access to what is in store to supplement stock at the place of business. To that extent, the client will need to know the exact location of the thing. This will already be difficult when the storer has more than one storage location. However, a default rule allowing substorage would compromise the client's legitimate interests too much. Therefore, under the present Article, subcontracting is not allowed for storage unless agreed otherwise. Such derogating contractual agreements will often be made if the storer uses outsourcing methods.

In the case of an emergency situation, substorage may be the only means to preserve the thing. The obligation to hand the thing over to a third party for storage then follows from the storer's obligation to take reasonable measures to prevent unnecessary deterioration, decay or depreciation of the thing. A specific provision stating that substorage is allowed in such a case is not needed.

IV.C.-5:103: Protection and use of the thing stored

(1) The storer must take reasonable precautions in order to prevent unnecessary deterioration, decay or depreciation of the thing stored.

(2) The storer may use the thing handed over for storage only if the client has agreed to such use.

COMMENTS

A. General idea

The Article contains a specification of the standard of care required of the storer: the storer must take reasonable precautions to prevent unnecessary damage to the thing accepted for storage, whether such damage is caused by the storer or the storer's staff, by third parties or by other external causes.

Illustration 1

A museum has Egyptian artefacts stored. The storer is to protect the artefacts against humidity, wind and changes in temperature.

Unless agreed otherwise, the obligation to exercise due care and to take precautionary measures does not require the storer to examine the thing regularly during storage, e. g. in order to discover potential diseases if perishable things are stored. Such an examination may, however, be required if the storer received information to that effect.

Illustration 2

A storer is requested to store onions. If the storer has reason to expect the occurrence of diseases after the onions have been handed over for storage, he must, in so far as this is reasonable, examine them.

The second paragraph deals with the question whether the storer may make use of the thing stored. It states that such use is only allowed if the client has agreed to such use. In some cases, the thing stored will lose all or some of its value if it is not regularly used. In such a case, agreement may be implied; failure to use the thing would then even constitute a breach of the storer's obligation to prevent deterioration or depreciation of the thing.

Illustration 3

A racehorse is kept in a stable not belonging to the owner of the horse. Whether or not the parties have explicitly agreed to this, the stable owner is both allowed and required to ride the horse regularly in order to keep the horse fit. Unless the client agrees thereto, the storer is not entitled to enter it into horse races, as such is not needed to keep the horse in good condition.

B. Interests at stake and policy considerations

The storer is usually in the best position to take protective measures to prevent damage to the thing while in storage. Damage must be prevented as much as possible, but there is a limit to what protective measures the storer can be expected to take: damage cannot under all circumstances be prevented, or only at very high costs. It would not be reasonable or economic to require the storer to take all possible precautionary measures.

Another issue is whether the storer may use the thing handed over for storage. Generally, the storer will not be allowed to do so without the client's consent, but this may be different when use of the thing is needed to prevent the thing from deteriorating. It could be argued that in such a case, consent to its use may be considered to be implied. On the other hand, one could also argue that if the client had agreed to such use, the client would have lent the thing to the 'storer'; if the client did not state such intention, the storer is only allowed to indeed take care of the thing, not to use it.

C. Comparative overview

In all legal systems, the storer's obligation of care requires the storer to undertake all reasonable measures to maintain the thing or prevent deterioration thereof. In Poland, this rule is mandatory even in a commercial contract; in Sweden, this is the case only if the client is a consumer. The storehouse is not liable if it could not have prevented the damage to the thing by exercising due care. In determining the extent of the care that may

be expected, the price for storage is to be taken into account. In all legal systems reported, the burden of proof that the damage to the thing was not caused by a lack of care is on the storer.

Use of the thing by the storer without the client's consent is generally not permitted. However, in many legal systems an exception is made if use is actually needed to preserve the thing. In these systems, the use of the thing follows from the storer's obligation to take care of the thing.

D. Preferred option

The storer is to take proper care of the client's interests when storing the thing. This implies that any measure, in so far as can reasonably be expected from the storer, must be taken to prevent *unnecessary* deterioration or decay of the thing during the period of storage. The storer must avoid any damage to the thing that can be avoided relatively easily.

The present Article may be seen as a particularisation of IV.C.–2:105 (Obligation of skill and care). That Article, which applies to all service contracts, must be taken into account in determining the obligations of a storer. Its provisions need not be repeated here.

An express provision that the storer may use the thing only if the client has agreed to such use is useful as it implies that, as a default rule, the use of the thing is generally not reconcilable with the nature of the contract. However, in a case where use of the thing is needed to prevent unnecessary deterioration or decay of the thing or of its value, consent may be considered to have been given tacitly. Moreover, in such a case, the storer will often be under an express or implied obligation to make use of the thing.

In the case of so-called irregular storage (irregular deposit) of generic things, the storer is not required to return the original things, but may sometimes be allowed to replace them with other things of the same quality and quantity. Where storage of such generic things is agreed upon, consent to the use of the thing may sometimes be implied. In fact, the contract may be then a mixed contract of storage and hire, loan or even sale. To such a contract, the rules on storage apply, with appropriate modifications, to the part of the contract that involves storage.

Similarly, if the client has impliedly or explicitly consented to the use of the thing – e. g. because use of the thing is needed for its preservation – the contract is probably of a mixed nature. This will often be a mixture of storage and loan, but may also be a mixture of storage and processing.

Illustration 4

A racehorse is kept in a stable not belonging to the owner of the horse. The stable owner is both allowed and required to ride the horse regularly in order to keep the horse fit.

In this case, the contract concerns a mixture of storage as the main object of the contract and maintenance as a type of processing as an ancillary obligation under the contract. In this case, the maintenance of the horse consists in riding it. The mixed nature of the contract implies that, with appropriate modifications, the present Chapter applies to the part of the contract that involves storage and the Chapter on Processing applies, with appropriate modifications, to the part of the contract that involves maintenance; cf. II.–1:108 (Mixed contracts). As both the storer and the processor are under an obligation to take precautionary measures to prevent damage or injury to the horse this will most likely not lead to practical differences.

When a storage contract is performed for nothing or for a merely symbolic price, the gratuitous or almost gratuitous nature of the contract may influence what the client may expect of the storer.

Illustration 5

At the price of € 0.20, a client stores his motor scooter in a garage before he goes shopping. When the client comes back, the scooter is missing. As the service was performed almost gratuitously, the garage owner's obligation to exercise due care does not include the obligation to have the garage guarded, but he is to introduce a way of preventing theft, e. g. by issuing tickets that may serve as proof of storage.

IV.C.–5:104: Return of the thing stored

(1) Without prejudice to any other obligation to return the thing, the storer must return the thing at the agreed time or, where the contractual relationship is terminated before the agreed time, within a reasonable time after being so requested by the client.

(2) The client must accept the return of the thing when the storage obligation comes to an end and when acceptance of return is properly requested by the storer.

(3) Acceptance by the client of the return of the thing does not relieve the storer wholly or partially from liability for non-performance.

(4) If the client fails to accept the return of the thing at the time provided under paragraph (2), the storer has the right to sell the thing in accordance with III.–2:111 (Property not accepted), provided that the storer has given the client reasonable warning of the storer's intention to do so.

(5) If, during storage, the thing bears fruit, the storer must hand this fruit over when the thing is returned to the client.

(6) If, by virtue of the rules on the acquisition of ownership, the storer has become the owner of the thing, the storer must return a thing of the same kind and the same quality and quantity and transfer ownership of that thing. This Article applies with appropriate adaptations to the substituted thing.

(7) This Article applies with appropriate adaptations if a third party who holds sufficient title to receive the thing requests its return.

COMMENTS

A. General idea

One of the main characteristics of a storage contract is that the thing ultimately is to be returned to the client by the storer, in principle unaffected by its storage. A storage contract basically states that both parties have, in normal situations, the right to enforce the return of the thing and that the mere fact that the client has accepted the return of the thing does not mean acceptance that the storage has been done in conformity with the contract. Therefore, by accepting the return of the thing the client does not lose the right to terminate the contractual relationship (leading to extinction of the obligation to pay the price) or to damages.

Illustration 1

Cocoa beans were stored in a warehouse. Upon the request of the client, the storer returns the cocoa beans. The fact that the cocoa beans were not stored properly and have become mouldy does not entitle the client to refuse their return. However, the client remains entitled to claim damages and to terminate the contract on the ground of fundamental non-performance.

The use of the word “return” in this Article does not imply that the storer has to take the thing to the client. The general rule is that a non-monetary obligation (such as the obligation to return the thing) has to be performed at the debtor’s place of business. If the debtor has more than one place of business the relevant place is the place having the closest relationship to the obligation. (III.-2:101 (Place of performance)) So the place of return will normally be the place where the thing is stored. Of course, this will often be regulated by the terms of the contract.

If the client, because of the damage inflicted upon the thing by the storer refuses to accept the return of the thing, the client is in breach of the obligation to that effect. Paragraph (4) introduces a specific remedy for the storer: escaping from the obligation to continue storing the thing by selling the thing to a third party. Under deduction of the price for storage, the storer must pay the proceeds of the sale to the client. The storer may only do so after having warned the client of that sanction.

The client may request the return of the thing at any time, even if the contractual period for storage has not yet lapsed. If the client requests the return of the thing before the service has been performed, this may amount to termination of the contract under IV.C.-2:111 (Client’s right to terminate), which means that the storer is still entitled to receive the contract price.

Illustration 2

Carlos holds 10,000 DVD players in storage for Eric, the owner of a number of retail shops. Due to an unexpected increase in demand, the stocks in Eric's shops are sold out. Even though the parties agreed that Carlos would store the DVD players for a period of two months, Eric may claim the instantaneous return of the DVD players, but he must pay the price for storage of the DVD players for the entire contract period.

If, during storage, the thing has borne fruit, the storer must return the fruit together with the thing itself.

Illustration 3

A farm is struck by lightning. The farmer succeeds in saving his cows, one of which is pregnant at the time. As the cowshed was destroyed, the cows are kept at a neighbouring farm. After the cowshed has been rebuilt, the farmer claims back his cows and the calf that was born in the meantime.

B. Interests at stake and policy considerations

The storer is required to store the thing in accordance with the contract, which entails costs for the storer; moreover, continued storage of the thing may prevent the storer from concluding or performing other storage contracts for lack of storage capacity. Moreover, the storer has an interest in being able to demand acceptance of the return of the thing by the client, as acceptance of the return of the thing or an unjustified refusal to accept return by the client has the effect that payment becomes due. Similarly, the client has an interest in having the thing returned whenever it is needed. The present Article deals with these interests, as well as with the consequences of the return of the thing: does acceptance of the return of the thing imply acceptance of any defects in the service or damage to the thing?

Another question is whether the client needs personally to demand the return of the thing (and go and collect it). In practice, it will often happen that the client has sold the thing to a third party and is no longer interested in its return. The third party does have an interest in the return of the thing, but does not have a contract with the storer. In some cases, the law of property may have resulted in ownership passing to the third party. Then the question arises whether the storer is entitled to withhold the thing until payment has been made for the storage. Moreover, the storer will need sufficient proof that the third party is indeed entitled to claim the return of the thing in order to prevent the client from claiming non-performance of the storer's obligation to return the thing.

A different problem may arise if the thing is commingled with other things of the same kind belonging to the storer or other clients of the storer and, therefore, can no longer be identified as belonging to a particular client. In such a case, the law of property may bring about the transfer of ownership of the thing. Unless the client has – explicitly or impliedly – consented to such a mode of storage, storing generic things in such a manner that the client loses ownership will not be in accordance with the contract. (See IV.C. –

5:105 (Conformity)). However, it is not uncommon for the parties to agree either expressly or impliedly to such a mode of storage. For such cases, it must be asked what thing the storer needs to return to the client and how the ownership of that thing is transferred or retransferred.

C. Comparative overview

When no period was determined for the duration of the storage, the thing – together with any fruits it may have borne during storage – is to be returned when the client or the storer so demands. When a period for storage was fixed in the contract, the client may nevertheless demand earlier return in most legal systems, provided that the client compensates the storer for the earlier return of the thing. When the agreed period for storage has ended, the storer may demand acceptance of the return of the thing. In some legal systems, the client may be forced by court order to accept earlier return of the thing if the situation is such that the storer cannot be required to store the thing any longer as this has become impossible or immensely difficult.

When the client does not accept the return of the thing, in Austria the storer is entitled to have the thing stored by a third party at the cost of the client or to continue storage; in the latter case, the storer's liability is reduced and the client will be accountable for all the damage that results from the failure to accept the return of the thing. In Germany, non-acceptance of the thing by the client may occasionally amount to non-performance, but in any case leads to the applicability of the doctrine of *mora creditoris*. Under this doctrine, the client is not under a 'real' obligation to co-operate, but cannot invoke a non-performance on the part of the storer if, following the failure to co-operate, the thing is lost or deteriorates and the loss or deterioration cannot be attributed to the storer's conduct. In Spain, the storer may ask the court to order consignment of the thing with a third party. Alternatively, the storer may sell the thing in Austria, in England and Sweden. In France, Germany, the Netherlands and Spain, such a right does not exist; the storer may, of course, invoke other remedies, e. g. claim damages or demand specific performance of the obligation to accept the return of the thing.

D. Preferred option

The storer has a legitimate interest in being freed from the obligation to safely store the thing after the contractual period for storage has ended, and may moreover have an interest in ending storage of the thing, as there may be a need to make room for the storage of other things. Therefore, paragraph (2) is intended to enable the storer to force the client to accept the return of the thing. Paragraph (4) contains a solution for the situation in which the client fails to perform the obligation to accept the return of the thing: if the storer has sufficiently warned the client and the client nevertheless refuses to accept the return of the thing, the storer may sell the thing and – subtracting the costs of selling the thing and the price for storage – pay the proceeds to the client. The provision is the logical complement to the forced return of the thing under paragraph (2). However, given the fact that the client is not free to refuse the return of the thing, mere acceptance of the return of the thing cannot be construed as a waiver of any of the client's rights as regards non-performance of the storer's obligations.

The thing is in principle to be returned to the client. However, the client may not want to receive the thing, but may want to allow a third party to claim the return of the thing. This will often be the case in commercial storage contracts where the thing is sold during storage. Under the present Article the storer is both authorised and obliged to hand over the thing to such a third party. However, the storer does not lose the right to withhold the thing until either the client or the third party pays the price for storage, as the storer should not be worse off as a consequence of the transfer of ownership.

The present Article does not deal with the question whether the storer has become the owner of things handed over for storage because they have been commingled with other things stored by the storer. However, when such a mode of storage has been agreed upon, the client is not entitled to receive the same goods back. Instead, the client is entitled to receive goods of the same kind, quantity and quality. Moreover, the client is entitled to becoming the owner of the replacement goods. How ownership is transferred, is again a matter for the law of property.

Illustration 4

A farmer harvested 15,000 kilograms of grain. As he lacks storage capacity himself, he has the grain stored in a huge silo operated by a professional storer of grain. As the farmer knows and accepts, the silo does not contain compartments, implying that the grain cannot be separated from the grain handed over for storage by other farmers. When the farmer requests the return of the grain, the storer may return 15,000 kilograms of grain of the same kind and quality and transfer ownership thereof. This does not constitute non-conformity under IV.C. – 5:105 as the farmer, when the contract was concluded, knew that the grain would be commingled with grain delivered by other farmers and therefore accepted the method of storage of the grain and the resulting loss of ownership thereof during storage.

The present Article encompasses the obligation of the storer to actually return the thing. After the return of the thing, the client will usually be able to determine whether or not the service has been performed correctly and will then be required to inform the storer thereof within a reasonable time. More importantly, as the client bears the burden of proving that the damage to the thing occurred prior to its return, the client in fact has an interest in reacting quickly and in investigating the thing upon its return for apparent defects: proof of the prior existence of the damage becomes very difficult as time goes by.

Under a later Article (IV.C.–5:106 (Payment of the price)) the price becomes due when the storer returns the thing. Consequently, the obligation to return the thing and the obligation to pay the price for the storage are normally to be performed at the same time. Where and as long as the client refuses to pay, the storer may withhold performance of the obligation to return the thing in accordance with III.–3:401 (Right to withhold performance of reciprocal obligations), as is explicitly regulated in IV.C.–5:106

(Payment of the price). This applies even when a third party holding sufficient title to the thing claims the return of the thing, as the right to withhold the thing exists as long as the client (or the third party) has not paid the price for storage.

Both parties are in need of the other party's co-operation in order to establish the return of the thing. Paragraphs (1) and (2) of the present Article include an obligation for each party to contribute to the return of the thing. Non-performance of such an obligation entitles the other party to claim damages or to demand specific performance. However, these remedies offer insufficient relief if the client is negligent in the performance of the obligation to take the thing back and the storer has an immediate need to end the storage. To remedy that, III.-2:111 (Property not accepted) provides a particular remedy for the storer, i.e. to sell the thing and to pay the proceeds, less the costs incurred in selling the thing and, of course, the price for the storage. Paragraph (4) explicitly refers to that provision. However, before being allowed to exercise this right, the storer is required to give the client a reasonable warning of the intention to do so. By such a warning, the client is alerted to the possible consequences of the failure to accept the return of the thing; and is then given a final chance to perform the obligation to accept the return of the thing, thus preventing the loss of ownership over it. The notion of a reasonable warning implies that the storer must take reasonable measures to ensure that the client understands the content of the warning.

The present Article does not deal with the question *whether* or *how* ownership has been transferred because the thing has been sold to a third party or was commingled with other things stored by the storer. Such questions are left to the law of property. Of course, as is provided in IV.C.-2:106 (Obligation to achieve result) paragraph (2), the thing that is returned must be free from any right of a third party that did not exist prior to the conclusion of the contract.

The law of property is also to determine when the third party holds sufficient title to demand the return of the thing. This will usually be the case if the third party produces a store warrant issued by the storer when the thing is stored.

IV.C.-5:105: Conformity

(1) The storage of the thing does not conform with the contract unless the thing is returned in the same condition as it was in when handed over to the storer.

(2) If, given the nature of the thing or the contract, it cannot reasonably be expected that the thing is returned in the same condition, the storage of the thing does not conform with the contract if the thing is not returned in such condition as the client could reasonably expect.

(3) If, given the nature of the thing or the contract, it cannot reasonably be expected that the same thing is returned, the storage of the thing does not conform with the contract if the thing which is returned is not in the same condition as the thing which was handed

over for storage, or if it is not of the same kind, quality and quantity, or if ownership of the thing is not transferred in accordance with paragraph (6) of IV.C.-5:104 (Return of the thing stored).

COMMENTS

A. General idea

The present Article states that a storage contract, unless of course the parties agreed otherwise, implies an obligation of result: normally, if the thing is not returned in the same condition as it was in when it was handed over to the storer, the contract has not been performed correctly. The present Article thus enables the client to establish the storer's liability.

Illustration 1

A shipment of DVDs is stored in a warehouse. When the client claims their return, it turns out that they are damaged. The storer is, in principle, liable for non-conformity of the service.

However, the storer may still prove that the fact that the thing is not returned in its original condition is due to *force majeure*. Moreover, the detrimental consequences of this strict liability of the storer are, to a large extent, redressed by the storer's possibility of limiting liability in a commercial storage contract to the value of the stored thing.

The nature of the thing handed over for storage may imply that the thing may or has to be returned in a different condition. The thing then is to be returned in the condition that the client could reasonably expect it to be in upon return, be it in a better or a worse condition than it originally was.

Illustration 2

Bananas that are already ripe are stored. The mere fact that the bananas have coloured brown when they are returned does not mean that the storer is liable, since the brown colouring of overripe bananas is a natural process.

Illustration 3

Cheese is stored in order to mould. The storer only needs to preserve the cheese and is not required to do anything with the cheese but to store it safely. From the nature of the thing handed over for storage it follows that the cheese cannot be returned in the same condition as it was in when it was handed over. Instead, it will be returned in a better and more valuable condition.

Illustration 4

Because a town's refuse dump is closed due to a strike, the rubbish is temporarily stored. Given the natural decay of the rubbish, the storer is not obliged to return

the rubbish in the same condition as it was in when it was handed over to the storer.

B. Interests at stake and policy considerations

While in most services contracts the service provider is merely under an obligation of best efforts (obligation of means) and obligations of result are mainly limited to secondary obligations, on the basis of a storage contract the client may normally expect a concrete result, i.e. that the thing will be returned in the condition it was in when it was handed over for storage. In this sense, storage implies the safekeeping of the thing. However, in some cases it follows from the nature of the thing stored that return of the thing in its original condition cannot reasonably be expected. An important example is the storage of perishable things, such as fruit.

The question then arises whether the *default rule* should be that the storer is under an obligation to return the thing in its original condition unless that cannot reasonably be expected given the nature of the thing, or that there should only be an obligation to use best efforts to bring this about. In practice, the difference is primarily a matter of proof: does the client only have to prove that the thing was not handed back in its original condition, allowing the storer to prove that due care was exercised and that the change of the condition of the thing could not have been prevented, or is it up to the client to prove not only the change in the condition of the thing, but also negligence on the part of the storer?

C. Comparative overview

In some legal systems, notably Belgium, France, England, Germany and Italy, the storer is required to return the thing to the client in the condition the client may expect; the risk of natural deterioration or decay of the thing is to be borne by the client, but it is up to the storer to prove that loss of, or damage to, the thing was not due to any negligence on the storer's part. In other legal systems, notably Austria, the Netherlands and Spain, the starting point is that the thing is to be returned in its *original* condition, together with all the increases (fruits), but here, too, the risk of natural deterioration or decay of the thing is to be borne by the client, and again the burden of proof of non-negligence is on the storer. In practice, the two approaches lead to the same result, requiring the storehouse to prove that it cannot be held liable for any loss of or damage to the thing.

D. Preferred option

Storage is to take place in accordance with the contract; if the thing is not stored accordingly, the storer is liable for any resulting damage. Moreover, the storer is normally required to return the thing in its original condition (paragraph (2)) – which would qualify as an obligation of result – whereas paragraph (3) states that only an obligation to return the thing in as good a condition as could be expected exists if return of the thing in its original condition could not be expected given the nature of the thing handed over for storage. Paragraph (4) deals with the situation where, in conformity with the contract, the thing stored is commingled with other things of the storer or of third parties, and the storer is required to return another thing of the same kind, quality and

quantity and, if need be, to transfer ownership. Since paragraph (2) contains the main rule and paragraphs (3) and (4) the exceptions, the burden of proof that either paragraph (3) or paragraph (4) applies is on the party who wishes to rely on it. In most cases, that party will be the storer; however, in *Illustration 3*, that party is the client.

IV.C.–5:106: Payment of the price

(1) The price is payable at the time when the thing is returned to the client in accordance with IV.C.–5:104 (Return of the thing stored) or the client, without being entitled to do so, refuses to accept the return of the thing.

(2) The storer may withhold the thing until the client pays the price. III.–3:401 (Right to withhold performance of reciprocal obligation) applies accordingly.

COMMENTS

A. General idea

The central question in this Article is when the client is to pay for the service rendered or to be rendered. The Article states that the price is normally due when the thing is returned to the client.

Illustration 1

Oranges were stored in a warehouse. Upon request of the client, the storer returns the oranges. Payment becomes due when the client accepts the return.

However, as the client is not entitled to refuse the return of the thing, the client should not by doing so be able to frustrate the storer's right to payment. To prevent this, the Article states that the right to payment also emerges when the client refuses to accept the return of the thing. This does not, however, mean that the client always has to pay the price for storage. If the client terminates the contract for fundamental non-performance, the obligation to pay the price is extinguished: if the client has already paid, restitution of the payment may be demanded.

The rule in the Article is only a default rule. The parties are free to derogate from this provision, and will often do so, especially in the case of a storage contract for a relatively long period of time.

Illustration 2

Oranges are stored in a warehouse. The parties have agreed upon payment for each month during which the oranges are stored, to be paid at the beginning of the month. In accordance with the contractual agreement of the parties, payment is due at the beginning of the relevant month.

B. Interests at stake and policy considerations

The general rules in Book III start from the assumption that both parties will perform their obligations simultaneously. In storage contracts, which by definition imply that the storer must perform the main obligation for a reasonably long period of time, simultaneous performance would mean that the client is also under a continuous obligation to perform, i.e. to pay. This, of course, would not be very practical. This implies that normally either the storer or the client is required to perform first. The party who must perform first has no certainty about the other party's intention to perform. A choice must be made whether the uncertainty is to be placed on the storer or on the client. An in-between position could be reached if the client were to pay part of the price after a period of storage has ended or before a new period starts. In this way, the risk on the party that is to perform first is reduced.

C. Comparative overview

In most legal systems, payment for storage is due when the storage ends, although in any legal system the parties may agree to a different time for payment and often do so. Especially in the case of commercial storage, a contractual arrangement to the extent that payment is due per period of storage is more common.

In the case of non-payment by the client, in most legal systems the storer may invoke the right of retention or otherwise withhold the thing. However, such a right to withhold the thing does not exist in Austria and in England.

D. Preferred option

In the present Article, the general trend in the European legal systems – that payment is due when the storer returns the thing – is followed. Thus the storer is to perform first. However, to prevent the storer from having to bear the risk of non-performance by the client completely, the storer is given a specific right to withhold the thing. Moreover, as the Article only contains a default rule, the parties may agree to a different time for payment to become due. In the case of a contract for an indefinite period of time, which will occur primarily in commercial storage contracts, the parties will normally make different arrangements as to the time when the price for the storage is to be paid.

IV.C.–5:107: Post-storage obligation to inform

After the ending of the storage, the storer must inform the client of:

- (a) any damage which has occurred to the thing during storage; and*
- (b) the necessary precautions which the client must take before using or transporting the thing, unless the client could reasonably be expected to be aware of the need for such precautions.*

COMMENTS

A. General idea

This Article imposes a specific obligation on the storer to give the client two different types of information. Firstly, if for some reason the thing was damaged during storage, the storer must inform the client of that. This is especially important if there is a chance that the client would not notice the damage immediately and would run the risk of greater damage if prompt action were not taken.

Illustration 1

A computer company has stored a hospital's electronic patient records. During storage, a major power cut has damaged the computer company's mainframe computer, damaging some of the records. The hospital will only be able to notice the damage if it specifically looks for information which is stored in the damaged files. The computer company is obliged to inform the hospital of the damage. After having been warned, the hospital can try to access backup files it may still have. If the hospital is not duly warned, the chances increase that such backup files will have been deleted.

Secondly, the storer may be under a duty to warn the client that precautions need to be taken before the thing is transported or used by him. Such a warning is, however, not necessary if the client can be expected to be aware of the need to take precautions.

Illustration 2

A woman has her furniture, including a refrigerator, temporarily stored because she has moved out of her old house but has not yet got entry to her newly built house. As the storer knows, a refrigerator should not be used for two or three days after it is moved from one place to another. The storer has, in principle, an obligation to warn the client of this when the refrigerator is handed back, unless the client could reasonably be expected to be aware of it already. As this is most likely the case, the storer will most probably not be under an obligation to warn the client.

B. Interests at stake and policy considerations

During storage, all sorts of things may happen to the thing, including damage. Often, such damage will be noticed by the client at the time or shortly after the thing is returned. However, certain types of damage may be hidden to the client while the storer may be aware of them, either because of professional expertise or because of awareness of the event causing the damage. If the storer does not inform the client, the damage to the thing may increase considerably as the client may fail to take the necessary measures to control the damage. On the other hand, imposing an obligation upon the storer to inform the client of damage that occurred during storage implies that the storer may have to report the storer's own non-performance of a contractual obligation.

A second question is whether the storer should have an obligation to warn against dangers when using or transporting the returned thing. One could argue that when the storer has properly taken care of the thing and returns the thing undamaged, the storage obligations have been fully performed. On the other hand, one could argue that it follows from the storer's obligation to take due care and to act in accordance with good faith and fair dealing that the storer must warn the client if aware of such dangers, even if these dangers have nothing to do with the performance of the service. An in-between solution would be that a duty to warn only emerges if the client would have no reason to be aware of the need to take these precautions.

C. Comparative overview

In most legal systems, an obligation to inform the client of the condition of the thing and the necessary precautions that the client must take before using or transporting the thing may occasionally follow from the storer's obligation of care or from the principle of good faith. In Spain, such an obligation is explicitly provided for in the case where the client is a consumer. Moreover, in several legal systems, e. g. Austria, England and Spain, the storer must inform the client about any damage that occurred to the thing during storage.

D. Preferred option

If damage occurred during storage, the client must be informed thereof, either upon return of the thing or before that. If duly informed, the client may be able to take appropriate measures to prevent further damage from occurring. Such is the case even if this means that the storer must inform the client of a non-performance, thus opening up the possibility of liability. It should, however, be noted that if the storer properly informs the client and the client takes appropriate measures in time, the extent of the damage may be limited. This would mean that the storer would be liable to pay damages to a lower amount, either because not all foreseeable damage has occurred or because the occurrence of part of the damage should have been prevented by the client, which would mean that that part of the damage is to be attributed to the client rather than to the storer.

The storer is, of course, only required to inform the client of such damage and of such dangers that the storer can be aware. When the thing handed over was sealed, the storer is not allowed to break the seal and cannot investigate it. Consequently, in the case of the storage of sealed things, obligations under this Article must be restricted to those cases where the seal was broken or where the damage can be noticed even though the seal has not been broken.

Illustration 3

A firm is preparing to move from one building to another. It has confidential records and office materials stored in a sealed wooden container. The storer may not investigate the container's contents and therefore cannot report the fact that an employee's fishbowl, stored in the container, was broken during transport. However, the storer must inform the client that the wooden container and its contents were destroyed by a fire in the warehouse where the container was stored.

The storer is under an obligation to warn the client that the client needs to take precautionary measures before transporting or using the thing if the storer is aware of dangers connected with its transportation or its use by the client, even if these dangers are inherent to the fact that the thing was stored or is transported by the client. The reason for such an obligation is that the storer may be aware of the dangers but the client may not. However, it would not be fair or reasonable to burden the storer with an obligation to warn against dangers the client can reasonably be expected to know of.

Both the obligation to inform under paragraph (1) and the obligation to warn under paragraph (2) operate at or after ending of the storage. The provision may be applied if the storage is temporarily suspended while the contract is still in force but, more importantly, also when the contractual relationship has come to an end for whatever reason.

IV.C.–5:108: Risks

(1) This Article applies if the thing is destroyed or damaged due to an event which the storer could not have avoided or overcome and if the storer cannot be held accountable for the destruction or damage.

(2) If, prior to the event, the storer had notified the client that the client was required to accept the return of the thing, the client must pay the price. The price is due when the storer returns the remains of the thing, if any, or the client indicates to the storer that the client does not want those remains.

(3) If, prior to the event, the storer had not notified the client that the client was required to accept the return of the thing:

(a) if the parties had agreed that the storer would be paid for each period of time which has elapsed, the client must pay the price for each period which has elapsed before the event occurred;

(b) if further performance of the obligations under the contract is still possible for the storer, the storer is required to continue performance, without prejudice to the client's right to terminate the contractual relationship under IV.C.–2:111 (Client's right to terminate);

(c) if performance of the obligations under the contract is no longer possible for the storer the client does not have to pay for the service rendered except to the extent that the storer is entitled to a price under subparagraph (a); and the storer must return to the client the remains of the thing unless the client indicates that the client does not want those remains.

(4) If the client indicates to the storer that the client does not want the remains of the thing, the storer may dispose of the remains at the client's expense.

COMMENTS

A. General idea

Sometimes the thing handed over for storage is damaged or destroyed without any fault or other cause attributable to the storer. Under the previous Article, the client must be informed of this when the thing is returned to the client. If the storehouse proves that the damage was caused by an impediment beyond its control, it is not liable for the damage. In that case, the damage to, or destruction of, the thing is to be borne by the client. It is, however, not clear whether the client still has to pay for the storage service.

In this Article, a distinction is made between the situation where the storer had already informed the client that the client was required to accept the return of the thing or the client had asked its return and the situation where the storer had not yet indicated that. In the former situation, the client bears the consequences of the unfortunate event: the client must still pay the price for the service rendered, even although the benefit of the thing can no longer be enjoyed.

Illustration 1

A shipment of 1,000 DVD players is stored at a warehouse for two months. When the two months have passed, the storer requires the client to take the DVD players back, as the storage facility is needed for storage of other things. Before the DVD players are collected, the warehouse is struck by lightning; in the resulting fire, the DVD players are damaged. The storer need only return the remains of the DVD players if the client is still interested in them, but the client is required to pay the price for the service that was rendered.

In the latter situation, a further distinction must be made as to whether performance of the service is still possible or not. If prolonged storage is still possible (and reasonable), the storer is to continue storing the thing, unless the client terminates the contractual relationship.

Illustration 2

A shipment of 1,000 DVD players is stored at a warehouse for two months. Before the contractual period has ended, a fire breaks out. Because of water damage, the DVD players are damaged, but not destroyed. The storer must continue storage, unless the client terminates the contractual relationship.

If storage is no longer possible, the storer is not entitled to payment and must return the thing or what remains of it to the client if the client wants to receive the thing or what remains of it.

Illustration 3

The DVD players are damaged to such an extent that they are of no further use. In this case, the storer must return the remains of the DVD players to the client if the client so requests, but does not have the right to payment.

As storage contracts usually are long-term contracts, the parties will often have agreed upon payment per period. The client is still required to pay for the periods that have ended even if future performance is no longer possible.

Illustration 4

A shipment of 1,000 DVD players is stored at a warehouse for two months. The parties have agreed upon monthly payment, to be paid after the relevant month has ended. When exactly one month has passed, a fire breaks out, destroying the entire shipment. The client need only pay for the first month of storage.

B. Interests at stake

The question to be answered here is who should bear the consequences of the unfortunate destruction or deterioration of the thing. In most cases, the causes for non-performance will be attributed to one or the other party. Damage caused by natural disasters such as landslides and flooding, for instance, will occur less frequently because storers will have taken precautionary measures – failure to do so when such measures should have been taken implies a non-performance by the storer – and public authorities have taken preventive measures as well. Yet, where such damage does occur and no obligation of the storer was breached, the question needs to be answered.

In this respect, the question also arises whether the storer may still claim performance of the client's obligation to pay the price when the thing has been destroyed or damaged due to an incident for which the storer cannot be held liable.

D. Preferred option

The practical relevance of the present Article is relatively low. Many events that were once considered unforeseeable or insurmountable are now within the reach of affordable preventive measures. As a consequence, the storer will have far-reaching obligations to protect the thing against the consequences of external events. However unexpected events for which the storer cannot be held accountable may still occur.

Paragraph (1) states when the Article applies. The essence is that there must be some unforeseen event and that the storer must not be accountable for the destruction or damage caused.

If the client or the storer had already indicated that the thing was to be returned, but the client had not yet collected the thing, the client bears the consequences of the unfortunate event, and must still pay the price for the service rendered. For the only reason why the

storer still had the thing was that the client had not yet collected the thing; in such cases, it is deemed to be fair that the client bears the consequences.

In the situation where the desire to have the thing returned had not yet been communicated to the other party, the consequences of the unfortunate event are covered by the principles of III.-3:104 (Excuse due to an impediment). If the non-performance is not excusable under this Article and prolonged storage is still possible (and reasonable), the storer is to continue storing the thing, unless the client terminates the contractual relationship. If the storer continues storing, the storer is entitled to the contractual price; if the client terminates, the storer is entitled to the value of the services already rendered. (IV.C.-2:111 (Client's right to terminate) paragraph (2)). Where the parties had agreed upon payment per period, the client need only pay for the periods that passed before the unfortunate event took place. If storage is no longer possible or reasonable, the storer is not entitled to payment and is to return the thing or what remains of it to the client if the client wants to receive the thing or the remains. However, as storage contracts usually are long-term contracts, the parties will often have agreed upon payment per period.

Contrary to the situation under a construction contract, and unless the thing is commingled with other things, the client is normally the owner of the thing. So the situation where the risk is completely on the storer normally does not occur under a storage contract. The risk of the loss of the thing itself is on the owner of the thing (*res perit domino*). Total loss of the thing, therefore, will normally have to be borne by the client, who is the owner. The present Article is primarily concerned with the effect of destruction or damage on the obligation to pay the price.

IV.C.-5:109: Limitation of liability

In a contract between two businesses, a term restricting the storer's liability for non-performance to the value of the thing is presumed to be fair for the purposes of II.-9:406 (Meaning of unfair in contracts between businesses), except to the extent that it restricts liability for damage caused intentionally or by way of grossly negligent conduct on the part of the storer or any person for whose actions the storer is responsible.

COMMENTS

A. General idea

The present Article creates a relatively safe haven for a specific type of limitation clause in storage contracts: if in a contract between two businesses the storer's liability is limited to the value of the thing before storage, that clause is presumed to be fair for the purposes of II.-9:406 (Meaning of unfair in contracts between businesses) which deals with unfair contract terms in contracts between businesses.

Illustration 1

A company specialising in improving foodstuffs harvested 15,000 kilograms of genetically modified grain. As the company lacks storage capacity, the grain is stored in a huge silo operated by a professional storer of grain. At the time of storage, genetically modified grain is not approved for consumption or distribution in the food chain. Due to the somewhat negligent behaviour of an employee of the storer, the grain is accidentally mixed with normal grain and sold as seed for new crop. When the error is noticed, the harvest of 2,000 farmers is destroyed; the farmers claim damages from the producer of the genetically modified grain on the basis of public regulations, which state that the producer of grain is strictly liable for any damage caused by the grain before approval for distribution in the food chain. When the producer claims damages from the storer, the storer invokes a standard term restricting liability to the market value of the grain at the time it was stored.

As both the producer of the grain and the storer act in the course of their business, the limitation clause is presumed to be fair.

The presumption of fairness does not apply to the extent that the term restricts liability for damage caused intentionally or by way of grossly negligent behaviour on the part of the storer or any person for whose actions the storer is responsible.

Illustration 2

A large oil company has 10,000 barrels of oil temporarily stored at a storage location, owned by a commercial refinery. The standard terms of the storer form part of the contract and include a clause limiting the refinery's liability to the value of the oil at the time of storage. An employee of the refinery, against regulations, smokes a cigarette and carelessly throws away the stub. The stub causes the oil barrels to explode, leading to an inferno at the refinery.

As in this case the employee's actions may be considered to constitute grossly negligent behaviour, the presumption of the present Article does not apply; whether the clause is regarded as unfair in relation to such situations is to be determined under the general rules on unfair contract terms in contracts between businesses.

B. Interests at stake and policy considerations

There are general rules on unfair contract terms in Book II, Section 4. This does, however, lead to case-by-case appreciation of exemption and liability clauses, causing uncertainty as to the validity of such clauses. As a result, parties will have an interest in litigating the question whether or not the clause can be invoked. It would certainly benefit commercial practice if more guidance could be given in this matter. The question then arises whether the present Chapter should contain a specification of the general provision, indicating that particular clauses are presumed to be fair in a storage contract. A further question would be whether such a clause would also be upheld in a case where damage was caused intentionally or by way of grossly negligent conduct. On the other hand,

introducing such a rule would take away some of the flexibility of the general rules on unfair contract terms. Moreover, one could argue that one should distinguish between commercial contracts and consumer contracts, in the sense that a general rule is more acceptable in commercial contracts than in consumer contracts.

C. Preferred option

At present, the legal systems are divided as to the acceptability of limitation clauses. In this Chapter, an in-between solution is followed by the introduction of a so-called safe havens for commercial storage contracts. In such contracts, a clause restricting the storer's liability for non-performance to the value the thing had before storage is *presumed* to be fair and reasonable. The presumption, however, is not generally applied. Firstly, it does not apply to the extent that the clause restricts liability for damage caused intentionally or by way of grossly negligent conduct. In this respect, it cannot be argued convincingly that a clause limiting or excluding liability even in those cases should *always* or even *normally* be considered to be fair. Therefore, clauses excluding liability for damage caused intentionally or by way of grossly negligent conduct must be excluded from the present Article. Whether such clauses are effective or not is to be determined on the basis of the general rules on unfair contract terms.

Secondly, the client may prove that, despite the presumption in this Article, in the case at hand the clause cannot be considered fair. Such proof will be difficult, but that is no bad thing. The Article aims at providing practice with hard and fast rules for one of the most important types of exclusion or limitation clauses in storage contracts. That goal would be achieved if proof of the opposite were easily accepted.

Thirdly, the presumption only applies to *commercial* cases. In consumer cases, the damage inflicted by a non-performance on the part of the storer is normally fairly limited. Usually, both the extent of the damage and the risk of its occurrence are not so extreme that they cannot be borne by the storer. There is, therefore, insufficient reason to introduce a safe haven for consumer cases. This does not mean that a clause limiting liability in a consumer case cannot be accepted; whether the clause is effective is to be determined in accordance with the general rules on unfair contract terms.

IV.C.-5:110: Liability of the hotel-keeper

(1) A hotel-keeper is liable as a storer for any damage to, or destruction or loss of, a thing brought to the hotel by any guest who stays at the hotel and has sleeping accommodation there.

(2) For the purposes of paragraph (1) a thing is regarded as brought to the hotel:

(a) if it is at the hotel during the time when the guest has the use of sleeping accommodation there;

(b) if the hotel-keeper or a person for whose actions the hotel-keeper is responsible takes charge of it outside the hotel during the period for which the guest has the use of the sleeping accommodation at the hotel; or

(c) if the hotel-keeper or a person for whose actions the hotel-keeper is responsible takes charge of it whether at the hotel or outside it during a reasonable period preceding or following the time when the guest has the use of sleeping accommodation at the hotel.

(3) The hotel-keeper is not liable in so far as the damage, destruction or loss is caused by:

- (a) a guest or any person accompanying, employed by or visiting the guest;*
- (b) an impediment beyond the hotel-keeper's control; or*
- (c) the nature of the thing.*

(4) A term excluding or limiting the liability of the hotel-keeper is unfair for the purposes of Book II, Chapter 9, Section 4 if it excludes or limits liability in a case where the hotel-keeper, or a person for whose actions the hotel-keeper is responsible, causes the damage, destruction or loss intentionally or by way of grossly negligent conduct.

(5) Except where the damage, destruction or loss is caused intentionally or by way of grossly negligent conduct of the hotel-keeper or a person for whose actions the hotel-keeper is responsible, the guest is required to inform the hotel-keeper of the damage, destruction or loss without undue delay. If the guest fails to inform the hotel-keeper without undue delay, the hotel-keeper is not liable.

(6) The hotel-keeper has the right to withhold any thing referred to in paragraph (1) until the guest has met any claim the hotel-keeper has against the guest with respect to accommodation, food, drink and solicited services performed for the guest in the hotel-keeper's professional capacity.

(7) This Article does not apply if and to the extent that a separate storage contract is concluded between the hotel-keeper and any guest for any thing brought to the hotel. A separate storage contract is deemed to have been concluded if a thing is handed over for storage to the hotel-keeper.

COMMENTS

A. General idea

The Article deals with the general liability of hotel-keepers for loss of, or damage to, things brought to the hotel by guests staying at the hotel. It does not deal with cases where there is a special storage contract between the guest and the hotel (paragraph (6)) Such cases are quite common.

Illustration 1

A Viennese hotel offers its guests the possibility of storing valuables in the hotel safe. A hotel guest hands over her passport, money and air ticket to the hotel-keeper for safekeeping in the hotel safe.

Illustration 2

A hotel guest stays in a hotel in Rome for three nights. As, on the day of his departure, his plane does not leave until 18.00 hrs., he asks the hotel-keeper whether he can leave his luggage at the hotel. The hotel-keeper offers to store the luggage in a special room.

According to paragraph (6), the two cases described above do not fall within the scope of the present Article, but under the rest of this Chapter. This also applies for the storage of money in the hotel safe, as follows from the last sentence of the paragraph.

A separate storage contract is not normally concluded for things stored in a hotel room, even if the thing is locked into a safe contained in the room, as the hotel is not in a position to supervise the contents of such a safe. The present Article nevertheless provides that the hotel-keeper is to be treated as a storer with regard to the things the guest has brought to the hotel. This means that the obligations mentioned in the previous Articles apply so far as possible. Treating the hotel-keeper as a storer only applies in relation to a thing 'brought to the hotel' by the hotel guest. It follows from paragraph (2) that a thing is considered to have been brought to the hotel if it is brought by a guest to the guest's hotel room or if it is outside the hotel but the hotel-keeper otherwise accepted responsibility for it.

Illustration 3

A hotel guest has brought a suitcase into her room and has left her car, with the permission of the hotel-keeper, in the hotel's secured parking place. Both the suitcase and the car have been brought to the hotel. Had the car been parked in the public street, the hotel-keeper would have been responsible for the car and its contents.

Moreover, the hotel-keeper is also responsible for the guest being able to take things from and bring things to the room. Therefore, things are also considered to have been brought to the hotel in the period that precedes or follows the moment the client has checked in and gone to the room, and has checked out and left.

Illustration 4

A guest wants to check into a hotel. A pickpocket steals his wallet in the hotel lobby. The hotel is liable if it did not take appropriate measures to prevent such theft in the hotel.

The hotel is, of course, only liable if it could or should have prevented anything occurring to a thing brought to the hotel.

Illustration 5

A wallet is stolen from the room of a guest. The hotel-keeper is not liable if the wallet was stolen by a visitor who had entered the room with the guest's consent, but is liable if a chambermaid took the wallet.

Illustration 6

A fire breaks out in a hotel. The hotel staff quickly extinguish the fire but one room is completely destroyed, together with the things brought into it by the guest. Unless the damage can somehow be attributed to a failure on behalf of the hotel-keeper (e. g. because not enough fire-preventing measures were taken), the hotel-keeper is not liable for damages.

Illustration 7

A hotel guest brought overripe bananas to his room. The fact that the bananas will rot unless the guest immediately eats them follows from the nature of the thing brought to the hotel. The hotel-keeper will not be liable if the bananas indeed rot, nor if that causes damage to other things belonging to the guest.

B. Interests at stake and policy considerations

The present Chapter primarily deals with contracts where storage is the main object of the contract. Often, storage goes together with the performance of another service. If there is only one contract, the general rule on mixed contracts (II.-1:108 (Mixed contracts)) has the effect that the rules of this Chapter apply to the storage part of the contract, with any appropriate modifications. A typical situation in which a combination of services exist is when valuables are stored in a hotel safe or when luggage is temporarily stored in a special room after the guest has checked out. One could argue that the storage rules could be applied, though modified to take into account that storage is only an ancillary obligation under the contract, which has the provision of accommodation as its main obligation. On the other hand, one could also argue that in such a case, the parties have in fact concluded two separate contracts: one for accommodation – a contract which is governed by Chapter 2 (Rules Applying to Service Contracts in General) only – and a storage contract as to the storage of the valuables or the luggage. One could, however, doubt whether the storage rules should apply to the hotel-keeper who upon the guest's request stores the guest's money in the hotel safe, as the present Chapter does not generally apply to the storage of money (IV.C.-5:101 (Scope)). On the other hand, the reason for the non-applicability of the storage rules to the storage of money is that normally specific regulations apply to such contracts. These rules, however, do not apply to the situation where, in the course of a contract with a hotel-keeper, money is stored in the hotel safe.

In the contracts with a hotel-keeper, a second issue may arise: is the hotel-keeper responsible for damage to the guest's things while the guest is staying at the hotel? The question is difficult to answer as regards the things the guest brought into the room: the hotel-keeper does not have control over the things that are kept in the room. From this it follows that for such things the hotel-keeper does not act as a storer. One could, therefore, argue that the present Chapter should not govern the liability of a hotel-keeper. On the

other hand, the hotel-keeper's liability for things brought to the hotel by a guest has traditionally been regulated in the same or a very similar manner as the liability of a storer. Moreover, as the hotel-keeper normally provides cleaning services and therefore does have access to the room, even if the guest has locked it, there is a serious chance that any damage that is inflicted on a thing brought to the hotel is in fact inflicted by the hotel-keeper or hotel staff. The situation, therefore, is not so different from real storage. One could therefore argue that the present Chapter should contain a provision on the liability of a hotel-keeper, regulating the matter in a manner similar to the storer's liability.

If a specific provision were to be included, one could argue that a hotel-keeper should only be liable for damage to the things brought to the hotel if the guest informed the hotel-keeper of the damage promptly after discovering it: if the guest does so only after returning home, it is far more difficult for the hotel-keeper to prove that the damage was caused by somebody for whose actions the guest was responsible; moreover, the guest also deprives the hotel-keeper of the possibility of reducing the damage. This would imply that the guest should lose the right to claim damages when the hotel-keeper is not informed without undue delay.

Another question could be whether the hotel-keeper should have less freedom than other storers to limit or exclude liability. An argument in favour of this might be that the amount of damages would almost always be relatively low – especially if it were regarded as contributory negligence for a guest not to keep valuables in the hotel safe when offered the possibility of doing so. An argument in favour of a less stringent liability is that a hotel-keeper, unlike a storer, often does not have the thing under direct control and may be able to do little to prevent damage, deterioration or loss.

C. Comparative overview

On 17 December 1962, under the auspices of the Council of Europe, the Convention on the Liability of Hotel-Keepers concerning the Property of Their Guests was adopted. The Convention has been ratified by twelve of the present EU Member States (Belgium, Cyprus, France, Germany, Ireland, Italy, Lithuania, Luxemburg, Malta, Poland, Slovenia and the United Kingdom). The Convention has been signed, but not or not yet ratified by three countries (Austria, Greece and the Netherlands). A total of ten countries (the Czech Republic, Denmark, Estonia, Finland, Hungary, Latvia, Portugal, Slovakia, Spain and Sweden) have neither signed nor ratified the Convention (status at 11 May 2007).

As the Convention has been ratified by many of the reported legal systems, it is not surprising that the rules on the liability of hotel-keepers are more or less the same in many legal systems in the European Union. Even in countries which have not yet ratified, the rules are more or less the same. As a result of the Convention, in many of the existing codifications, hotel- and innkeepers are by statutory provision considered to be storers as regards the luggage, clothes and other objects brought to the hotel or inn by the client. In the case of damage to or loss of such things, the hotel-keeper can escape liability only by proving that the damage was not caused by hotel staff or another person who came to the hotel.

Things handed over to the hotel-keeper or hotel staff are considered to have been brought to the hotel. The Convention leaves it up to the national systems how to treat the hotel-keeper's liability for the client's car and its contents, and for animals brought to the hotel: Article 7 of the Annex to the Convention excludes these from the scope of the hotel-keeper's liability and Article 2 (e) of the Convention allows the parties to the Convention to decide differently. In Belgium, Article 7 of the Annex is followed; in England, only the liability for the client's car and its contents is excluded. By contrast, if the car is parked in a designated area, the hotel-keeper is liable in Austria, Germany and the Netherlands.

In the Netherlands, all rules governing the hotel-keeper's liability are default rules and no statutory limitations exist. In other legal systems, the hotel-keeper may not limit liability if the keeper or hotel staff is the cause of the damage or the thing has been handed over into the care of the hotel-keeper. In other cases, the hotel-keeper's liability is limited: in Austria to € 1,100 for most objects and to € 550 in the case of precious objects, money or securities. In England, under the Hotel Proprietors Act 1956, the hotel-keeper is liable for an amount no greater than £50 for one thing or a total of £100 per guest. In Belgium, France and Italy, the ceiling is set at 100 times the amount of the price of accommodation for one night. In Germany, the same ceiling exists, with a minimum of € 600 and a maximum of € 3,500; in the case of money, securities and other precious things such as fur not used as clothes, a maximum of € 800 applies. In France, liability for damage to or loss of objects placed in the client's car, parked in a closed parking place belonging to the hotel, is limited to 50 times the amount of the daily accommodation. Further exclusions or limitations of liability are normally considered to be void in Austria, Belgium and Italy.

Probably as a counterbalance to the hotel-keeper's liability, in Austria, England, France, Germany, the Netherlands and Spain the hotel-keeper is awarded a specific right of retention of the thing brought to the hotel until all charges have been paid by the client and for which the hotel would be held liable in the case of damage; a similar right exists in Sweden, where specific legislation regarding the hotel-keeper's liability otherwise does not exist.

D. Preferred option

For those things that actually *are* taken into the hotel-keeper's custody, there is no reason to deviate from the rules on storage at all. Therefore, in such a situation, the present Article does not apply, but a separate storage contract is deemed to have been concluded. As specific legislation regulating the storage of money does not apply to the storage of money in a hotel safe during the guest's stay at the hotel, the present Chapter should apply to such storage as well. The present Article therefore explicitly states that its rules do apply to the storage of such things. This is in conformity with the Convention on the Liability of Hotel-Keepers concerning the Property of Their Guests, which contains provisions on the liability of hotel-keepers for theft of money brought into their hotels.

Such a specific contract is not concluded concerning the things brought into the guest's room. Yet, even though hotel-keepers are, as regards the luggage a client leaves in the hotel room, not storers in the actual sense of the word, there is a close resemblance to the issues at stake in storage contracts. The reason for the application of the storage rules is that because of the open character of these places – implying that not only the staff, but also other guests and third parties may enter and leave the hotel – the client runs the risk of theft or property damage, while not being in a position to establish who is responsible. To remedy that, hotel-keepers are urged to take precautionary measures to prevent theft or damage, the aim of the rules being that hotel-keepers have to assure the safety of the things their clients bring into their establishments. This implies that the present Chapter should indeed regulate the liability of hotel-keepers in a manner similar to storage contracts.

The hotel-keeper has a legitimate interest in being informed about damage in time, but there is no particular incentive for the guest to speedily inform the hotel-keeper. To provide such an incentive for the guest, the Article states that the guest loses the right to damages if the hotel-keeper is not informed without undue delay.

Illustration 8

A guest's suitcase is stolen in the hotel lobby; the hotel-keeper did not take sufficient precautions and can therefore be held liable. The guest decides not to tell the hotel-keeper immediately, as she does not want to cause a scene before she has received the contents of her safety deposit box, where her passport and plane ticket are stored. Three hours later, when these are returned to the guest, she complains about the missing suitcase. Had the guest promptly informed the hotel-keeper, the hotel-keeper might have tried to catch the thief. The guest's failure to inform the hotel-keeper promptly means that the hotel-keeper can no longer be held liable.

It is different, however, if damage was caused intentionally or by way of grossly negligent behaviour on the part of the hotel-keeper or hotel staff: in such a case, the guest must of course inform the hotel-keeper of the claim, but there is insufficient reason to protect the interests of the hotel-keeper to the detriment of interests of the guest.

Illustration 9

A guest succeeds in proving that a chambermaid has stolen his wallet. The fact that the guest told the hotel-keeper about the theft only at the time when he was able to prove the chambermaid had taken the wallet does not deprive him of his right to damages.

The hotel-keeper may, in principle, limit or exclude liability in the same manner as a storer may. However, in a contract with a hotel-keeper, the relevant damage almost always pertains to the personal belongings of the guest, even if the guest is a travelling salesman. Given the fact that, the amount of damages that would have to be paid is almost always relatively low, limitation or exclusion of the hotel-keeper's liability should

not be possible if the damage was caused intentionally or by way of grossly negligent behaviour of the hotel-keeper or hotel staff. Paragraph (4) therefore provides that a term excluding or limiting the liability of the hotel-keeper even in such cases is deemed to be unfair for the purposes of the rules on unfair contract terms in Book II, Chapter 9. Those rules are mandatory.

E. Relation to the Convention on the Liability of Hotel-Keepers concerning the Property of Their Guests

The present Article closely follows the Convention by copying the annex to that Convention, except the provisions on the limitation of liability. As to that exception: the Convention allows parties to the Convention to impose different limitations. Given the general rules on unfair contract terms in Book II, Chapter 9, it seems sufficient in the present Article to include a specific provision banning limitation and exclusion clauses that apply to damage caused intentionally or by way of grossly negligent behaviour on the part of the hotel-keeper or his staff.

CHAPTER 6: DESIGN

IV.C.–6:101: Scope

(1) This Chapter applies to contracts under which one party, the designer, undertakes to design for another party, the client:

- (a) an immovable structure which is to be constructed by or on behalf of the client; or*
- (b) a movable or incorporeal thing or service which is to be constructed or performed by or on behalf of the client.*

(2) A contract under which one party undertakes to design and to supply a service which consists of carrying out the design is to be considered as primarily a contract for the supply of the subsequent service.

COMMENTS

A. General idea

The act of designing can be described as the initial stage of a process in which conceptual or detailed (technical) ideas are put on paper by one party (the designer) for another party (the client). The second stage of the process consists in the realisation of these ideas, usually by a constructor under a separate construction contract. However, design may be part not only of construction projects but also of, e. g., industrial projects, software, fashion or logistics schemes. The present Chapter basically applies to the design of new immovable structures but can also be applied to the design of movable or incorporeal things and to the design of a service.

Illustration 1

A well-known brewery requests a designer to design a drinking glass for a new type of beer. The present Chapter applies.

The rules of this Chapter also apply to contracts under which the designer, apart from the design activity, has to carry out other services. In that situation, this Chapter applies only to the design part of the contract. (See II.–1:108 (Mixed contracts)). If the contract obliges the designer to carry out the design as well, for instance by constructing a new structure or by processing an existing movable or intangible thing, paragraph (2) provides that the contract is to be regarded as primarily one for supplying the subsequent service. This means that the rules applicable to the subsequent service will prevail in any case of conflict: the design rules will be applied only subsidiarily and only so far as necessary to regulate the design parts of the contract (II.–1:108 (Mixed contracts) paragraphs (2) and (3)).

Illustration 2

A designer and a client concluded a contract under which the designer is to design and construct a building. The rules of the present Chapter do not apply if and in so far as its rules conflict with the provisions of the Chapter on Construction. If the latter Chapter is silent on a particular issue, the rules of this Chapter may however apply so far as necessary.

B. Interests at stake and policy considerations

The main question is whether the Chapter should cover only the traditional design contracts (in the field of construction) or also other types of design activity, such as software design, fashion design and, more generally, the design of any type of movable thing.

Another question is whether the Chapter should apply only to design contracts or also to design contracts in combination with another service contract (e. g. construction and processing). The extensive approach by which the rules of the present Chapter are applicable to the design part of a mixed contract would have the advantage of providing for a similar regulation for two rather similar activities. Indeed, in a certain aspect, the design activity on the one hand and the carrying out of the design on the other hand are not very different for these activities are both oriented towards creating a structure.

On the other hand, the limited approach – by which a mixed contract involving the activity of designing is entirely governed by the provisions for the subsequent activity – has the advantage of avoiding borderline issues and will probably limit litigation. This may also be justified by the fact that, in practice, the quality of the design – and therefore the liability of the designer – is assessed after the design has been carried out. The rules on the subsequent service, carried out by the author of the design, will then suffice.

C. Comparative overview

In most of the European legal systems, there is no specific statutory law on design contracts. Usually, design contracts are dealt with in rules on more general contracts, such as service contracts (or contracts for work), construction contracts or assignment contracts. However, the design contract is also extensively dealt with in standard terms, which are frequently used in most European countries. In Belgium and France, standard terms are of less importance because there is mandatory statutory law dealing with the legal status and liability of architects but in the Netherlands, England, Germany and Sweden standard contract terms are often of greater significance than the rather general rules on contract law (though only to the extent that the contracting parties actually agreed on the standard contract terms).

D. Preferred option

The option preferred here is to apply the design rules primarily to the case where the design is for the construction of an immovable structure but to apply the rules also to other design activities, such as the design of movable or incorporeal things: fashion, websites or art design. This is provided for in paragraph (1). The underlying idea of this extensive scope of application is that all design activities involve rather similar processes and can therefore be governed by the same rules.

As regards mixed contracts involving design and another service, the general rules on mixed contracts in II.–1:108 (Mixed contracts) apply. The rules of this Chapter apply to the design part of such mixed contracts and the rules applicable to the other service (e. g. supervision of the actual carrying out of the design by another service provider, marketing and publicity services) will apply to the other part of the contract. However, if the other service consists of the carrying out of the design, paragraph (2), when read with II.–1:108 (Mixed contracts) paragraphs (2) and (3), gives priority to the provisions governing the subsequent service. The provisions for design will only apply in the event that the provisions for the other service do not contain rules concerning a particular issue and only so far as there is no conflict with those other rules.

Illustration 3

A new cooling system for the production of flat screens for televisions is being designed and applied by a service provider under a single contract. The provisions of the Chapter on Processing apply and prevail over the provisions on design.

So, for example, the Processing rules on limitation of liability and conformity will apply and not the Design rules. However, the design rules on keeping records will apply since the rules on processing do not provide for keeping records of design documents.

Where the contract is for design, construction and sale of a movable, the combined effect of paragraph (2) of the present Article and the rule in IV.A.–1:102 (Goods to be manufactured or produced) may be that the sales rules will be those which apply, particularly in relation to conformity and remedies for non-conformity. The rationale for

this is that in such a case the design and construction are simply means to an end: the client is interested in the end product.

The contractual duties of a designer often include supervision of the service to be undertaken subsequently. This is, of course, especially the case with an architect or engineer who undertakes to supervise the building or construction work carried out on the basis of the design. However, this may also apply to a software designer who supervises the actual production of the designed software program. The rules in this Chapter are, however, not based on the presumption that the duty to supervise is implied in the duty to design. Although it is true that supervision can be performed in connection with a design service, in practice supervision is also supplied as a separate service. This is the reason why this Chapter does not contain rules on supervision. Supervision services will be subject to the rules of Chapter 2 (Rules Applying to Service Contracts in General).

IV.C.–6:102: Pre-contractual duty to warn

The designer's pre-contractual duty to warn requires in particular the designer to warn the client in so far as the designer lacks special expertise in specific problems which require the involvement of specialists.

COMMENTS

A. General idea

This Article imposes a specific duty on the designer to inform and to warn the client before the contract is concluded. This duty is a particularisation of the pre-contractual duty of any service provider to warn under IV.C.–2:102 (Pre-contractual duties to warn), which states that both contracting parties are to exchange information about the service to be provided. Because the designer will base the performance of the design service upon the wishes and needs of the client, the designer will have to warn the client in time if any failures or inconsistencies are noticed. This means that the designer will have to point out to the client which additional experts may be needed in order to carry out the design optimally. As the designer may not have all the expertise required to achieve the result the client has in mind, the designer will have to warn the client if such expertise is needed. Failure to warn may lead to the result envisaged by the client not being achieved by the designer.

Illustration 1

A designer recognises that special analysis of the soil is needed and that he is not able to carry out such analysis himself. Before the contract is concluded, the designer warns the client and recommends the employment of a geodesist.

B. Interests at stake and policy considerations

The main question here is whether, apart from the general pre-contractual duty to warn, the designer should have a specific duty to inform the client when he lacks the special expertise to deal with problems that require the involvement of specialists. In favour of such a duty it can be argued that design is a very complex activity, often requiring knowledge about many fields and that it is reasonable to expect the designer to inform the client of any need there may be to engage further experts.

Illustration 2

In order to design the body of a car, the designer needs to be knowledgeable not only about aesthetics and aerodynamics, but also about the functioning of the engine and legal requirements concerning safety. If the designer does not have all this expertise, it is reasonable to expect the client to be warned before the contract is concluded of the need to hire specialists.

On the other hand, it could be argued that, if at the time of the conclusion of the contract the designer does not have all the expertise necessary, it is up to the designer to hire specialists during the performance of the service. This will in any case be required in order to supply a design fit for its purpose. However, the client may want to know before deciding to conclude the contract whether the designer has the necessary expertise, as this will probably save time and costs.

C. Comparative overview

The pre-contractual duty of the designer to warn is not commonly accepted in the European legal systems. An express rule on this duty could not be found. The pre-contractual duty to warn is usually derived from other general duties such as good faith, the contractual duty to inform and the contractual duty to warn the client (Belgium, France, Germany and Spain). Sometimes it is also established in case law (the Netherlands and Portugal), but it has not been found in enacted law.

D. Preferred option

It seems preferable to place a duty on the designer to inform the client in so far as the designer lacks special expertise regarding specific problems which require the involvement of specialists. Exchange of information needs to take place before the conclusion of the contract. This will allow the client to make an informed decision about the designer. Furthermore, it will allow both contracting parties to decide whether any specialists needed will be engaged by the client or by the designer.

The duty of the designer to warn – whether pre-contractual or contractual – has become one of the central issues in general construction law and related areas. Many disputes are eventually dealt with by deciding whether the designer was under a duty to warn the client or not. This rule, when read along with the general pre-contractual duty to warn under IV.C.–2:102 (Pre-contractual duties to warn), is intended to help to resolve such questions. The sanctions for breach of the duty are those laid down in that Article.

If the designer does warn the client before a contract is concluded that additional expertise will be needed, then it will be up to the client to decide how to react. In some cases the client may decide not to conclude a contract at all.

Illustration 3

A house owner wishes to have a design for the installation of solar panels and approaches an ordinary architect. The architect warns the client that he has no expertise in this specialised area but could do the plans for any structural alterations necessary. He supplies the names of some specialists. On making further enquiries the client discovers that the design and installation of a system would be much more expensive than thought and decides not to proceed with any contract.

If the client does decide to proceed with the contract it may be expected that the parties would resolve the question of whether the employment and payment of specialists is to be part of the designer's functions under the contract or if it is to be left to the client to conclude separate contracts with the necessary specialists. This would clearly have a significant bearing on the price. In practice the designer would take care not to undertake any obligation which would imply the possession of expertise which has already been expressly disclaimed. For these reasons, and because the post-warning situations could be very varied, it is not thought that a default rule on who has to engage specialists is necessary or desirable.

IV.C.–6:103: Obligation of skill and care

The designer's obligation of skill and care requires in particular the designer to:

- (a) attune the design work to the work of other designers who contracted with the client, to enable there to be an efficient performance of all services involved;*
- (b) integrate the work of other designers which is necessary to ensure that the design will conform to the contract;*
- (c) include any information for the interpretation of the design which is necessary for a user of the design of average competence (or a specific user made known to the designer at the conclusion of the contract) to give effect to the design;*
- (d) enable the user of the design to give effect to the design without violation of public law rules or interference based on justified third-party rights of which the designer knows or could reasonably be expected to know; and*
- (e) provide a design which allows economic and technically efficient realisation.*

COMMENTS

A. General idea

The present Article is a specification for design contracts of the general obligation of skill and care that is imposed upon any service provider under IV.C.–2:105 (Obligation of

skill and care). According to paragraph (a), the designer is to attune the design to the work of other designers with whom the client has contracted so as to enable there to be an efficient performance of all the services involved.

Illustration 1

An aesthetic designer is engaged to design a new type of sports car for a well-known car manufacturer. While doing the work, the designer will have to attune the work to the technical design for the car, which is supplied by another designer hired by the client.

According to paragraph (b), attuning of the design to the work of other designers may include integrating their work.

Illustration 2

While designing a new sports centre, the main construction designer will have to integrate into the design the work done by other designers such as those designing the air conditioning system and the floor coating.

According to paragraph (c), the designer is to include the necessary information for the interpretation of the design that is needed to perform the subsequent service.

Illustration 3

A fashion designer is requested to design a new men's clothes fashion line. After completion of the design, the designer will have to give all the information to the client which is reasonably necessary to enable the client, or another party on the client's behalf, to start producing the clothes.

The designer must either focus on a user of average competence or on a specific user made known to the designer at the time of conclusion of the design contract. If special needs of a particular user of the design are made known after the conclusion of the contract, the rules of IV.C.-2:107 (Directions of the client) apply, i.e. such a direction would probably have to be accepted by the designer, but additional costs would have to be borne by the client.

For the design to be fit for its purpose it will have to be in accordance with public law provisions and will have to respect private rights, as established in paragraph (d) of the present Article.

Illustration 4

A timetable for public transport is being designed. The designer has to take into account the fact that buses are not to exceed speed limits.

Illustration 5

An architect is requested to design a house which is to be built on land that is subject to a servitude or other right of a third party. The architect will have to take this fact into account when designing the house.

The designer is to have reasonable knowledge of public law rules as well as of third-party rights. It is not the designer's responsibility to obtain permits or licences, unless agreed otherwise, but the designer has to make the design in accordance with public law provisions. There will often be some uncertainty about whether work based on the design will be granted permission. Political decisions in particular cannot be foreseen. A reasonable service provider is not expected to foresee what cannot reasonably be foreseen.

A very important issue in design concerns economical and technically efficient planning. A corresponding duty is stated in paragraph (e). This provision implies the duty to stay within the cost estimate of the client, not to make any mistakes in the calculation of the costs and not to include any parts or steps in the process of the subsequent service that are unnecessary.

Illustration 6

A municipality wants to have a low-cost bus station designed. The designer, who would prefer to include modern but expensive materials in the design, must pay attention to not exceeding the client's cost limits.

B. Interests at stake and policy considerations

The designer is – like any other service provider – under the general obligation of skill and care laid down in IV.C.–2:105 (Obligation of skill and care). It may be asked whether additional, specific duties are needed for design contracts.

On the one hand it could be argued that the general rules are flexible enough and comprehensive enough to cover all that needs to be covered. On the other hand it could be argued that there are special features of the design contract which make some extra specification useful even if it is not essential. It could avoid disputes and save expense to have a checklist of the most important obligations of the designer regarding the care and skill required. Standard terms often specify such obligations but there are cases where standard terms are not used and where default rules could be useful.

C. Preferred option

Although a general rule on the obligation of skill and care already exists, it is thought useful to add some necessary elements which are typical for the obligation of skill and care to be expected from designers. The particular duties imposed by the present Article will induce the designer to make a design which meets the wishes and needs of the client. The paragraphs of this Article describe the most important tasks a designer has to carry out during the design process. One idea behind this Article is to encourage a very close

relationship between the client and the designer. They are dependent on each other for the creation of a design that is in conformity with the contract.

This Article must be read in conjunction with the general provision in IV.C.–2:105 (Obligation of skill and care).

IV.C.–6:104: Conformity

(1) The design does not conform to the contract unless it enables the user of the design to achieve a specific result by carrying out the design with the skill and care which could reasonably be expected.

(2) The client is not entitled to invoke a remedy for non-conformity if a direction provided by the client under IV.C.–2:107 (Directions of the client) is the cause of the non-conformity and the designer performed the obligation to warn under IV.C.–2:108 (Contractual obligation of the service provider to warn).

COMMENTS

A. General idea

The effect of the Article is that the design must be fit for its purpose. Design is to be seen as the starting point for a subsequent service, such as construction or processing. If the design is not fit for its purpose, the subsequent service cannot be carried out in a way which will meet the client's expectations.

This Article provides further specification, for design services, of the obligation to achieve the required result. The reasonable client may expect a designer to achieve the particular result through the performance of the service requested. Paragraph (1) states that the design is not in conformity with the contract unless it enables the client to achieve a specific result by carrying out the design, according to the standard of care required.

Illustration 1

An architect's firm has been requested to make a design for the restoration of a historical building. The facade with its fabulous step gable is to be integrated in the design. However, the step gable is not included, and this means that the subsequent service of the constructor will not be in conformity with the client's wishes. The designer did not perform the obligation under the present Article.

Illustration 2

In the same example, the design turns out to have perfectly integrated the step gabled facade of the building, but the constructor does not renovate the facade in the way set out in the design. Here, the designer did meet the obligation under the

present Article, even though the result envisaged by the client has not been achieved.

The rule in the Article is a default rule, applying unless the parties agree otherwise.

If the design is defective, as a result of which the subsequent service cannot be carried out in conformity with the requirements of the subsequent contract, the designer and the subsequent service provider may have solidary liability, particularly if the subsequent service provider failed to perform an obligation to warn of the risk. This means that the client can claim damages from both.

When the design is not in conformity with the contract due to a direction of the client and the designer did not fail to perform an obligation to warn, the client is not entitled to invoke a remedy for the non-conformity. This follows from paragraph (2).

Illustration 3

An architect is requested by a housing company to design a new apartment building in the centre of the city, with sufficient parking space in the basement of the building. During the design process the client instructs the designer to change the initial design of the basement so as to ensure that the residents will have more room for storage. The designer warns the client that this will result in fewer parking spaces, but the client is determined. When the design is completed, it appears that there is not enough room for all the residents' cars. Since the designer warned the client of the risk, the client is not entitled to invoke a remedy for this non-conformity of the design.

B. Interests at stake and policy considerations

Design liability is an important issue for both parties. The difficult question is the basis on which the liability of the designer should be established. This may either be a failure to exercise the design activity with the care and skill required, or the fact that the design service did not achieve the result that was expected by the client.

When liability for the defective design is established on the latter basis, the designer will have to remedy defects even when the designer met every relevant requirement regarding the assessment of the existing situation, the input of tools and materials in the design process and the skilful and careful carrying out of the design process. The only escape would be to show that one of the specific defences applied. This is the French approach, or the fitness-for-purpose test. When there is no fitness-for-purpose liability, the basic question will be whether the designer met the quality requirements in the course of the design process. In the first instance, one might argue that these two approaches are each other's opposites and that the designer's interests are best protected in the second approach. In practice, the differences may not be too big, however, especially when the burden of proving that all design process requirements have been met is put on the designer. In that case, the question would rather be which defences are allowed under

both regimes. This question would be particularly relevant to those design defects the occurrence of which is difficult to prevent and to control by the designer. The French approach would seem more client-friendly as it gives the client the choice of suing one of the service providers involved in the whole project.

Problems may arise when the fitness-for-purpose test does not apply. It would seem to be inconsistent to hold the designer liable for more than the subsequent service provider. Choosing the French approach would then raise the question whether the scope of application of the present Article should be limited to contracts for designs to be realised by subsequent service providers that are under a similar fitness-for-purpose obligation.

An advantage of the French approach would be that the quality of the outcome of the design activity might be easier to establish and to discuss than the quality of the overall design process itself that leads to such an outcome. It may, for instance, be hard to establish which inadequate choices in the design process preceded the occurrence of the apparent defect in the outcome of that process. Likewise, it will be difficult to establish the amount of care the designer showed whilst making these choices. Hence, it appears that the legal and other administrative costs of the liability system that is based on the French approach will probably be lower.

One might argue that the French approach may work better in connection with a compulsory insurance system, as the designer would have to pre-finance the whole amount of compensation if held liable to the client. In addition, it would seem appropriate to ensure that the subsequent service provider participates in the insurance system as well. However, the costs of liability insurance may increase the price the client has to pay for the design service. Under the alternative liability system, where the designer is under a duty of care and skill only, the client will in many cases allow the designer to remedy the design defects anyhow because the client wishes to obtain a structure that is fit for its purpose. This means that the client will also pay an extra price for the remedying, be it under the heading of a price for extra work and not under the heading of an element of the initial price destined for the coverage of the strict liability.

The choice of an acceptable designer's liability system will also depend on the frequency with which the designer is not able to achieve the result the client has in mind. Normally, where it will be relatively easy for the designer to create a design that is fit for its purpose, rather stringent liability is more acceptable than in situations where it is uncertain whether a design fit for its purpose will be accomplished.

Illustration 4

An architect has been engaged by a municipality to design an underground station. As solid soil conditions are needed for such a construction the designer has thoroughly examined the subsoil. The subsoil turns out to be too swampy. In this situation, it will be difficult for the designer to create a design that will be fit for its purpose. Therefore stringent liability is not appropriate.

Taking normal precautions may under most circumstances prevent major defects. This may not be the case for innovative structures, where the occurrence of design defects is difficult to prevent and control beforehand. One might argue that for such situations, provided that the liability rule is of a default nature, parties can modulate their duties and obligations and come up with special contractual arrangements adjusting the liability regime to their specific needs.

The European legal systems are divided on the issue of conformity. Some countries have a fitness-for-purpose liability system; others have a liability system based on negligence. Yet others have a mixed system with elements of both approaches.

D. Preferred option

The present Article takes the fitness-for-purpose approach.

The reason for this choice is that it is easier for the client to prove that the outcome of the design process is not in conformity with the result envisaged, than to prove that the designer made inadequate choices in the course of the design process, as a result of which a defect occurred. It will be hard to reconstruct what occurred during the design process and what went wrong. Furthermore, if the design is not fit for its purpose, the designer will be in the best position to correct the failure in the design (in order to arrive at an improved version of the defective design), so that the constructor is able to repair the defective building. Improvement of the design can best be done by the original designer.

Given that, in general, the designer is expected to be able to create a design that is fit for its purpose, the approach adopted seems the more acceptable one. However, this rather stringent system of liability may sometimes create problems for the designer. For instance, when the client instructs the designer to use rather innovative structures for the design, the risk of defects in the design cannot be prevented or controlled beforehand. It may also be difficult for the designer to determine how the subsoil conditions, on the basis of which the building that is to be designed will be constructed, will be influenced by the actual construction of the building. This means that the designer is not always able to establish beforehand how the design and the conditions of the soil are to be attuned to one another. If the designer has conducted a state-of-the-art investigation and nevertheless overlooks something, the design will be defective and the designer will be liable under the present Article. In these difficult cases, the fitness-for-purpose test is a heavy burden on the designer, who will be held liable for the outcome of the design even though everything possible has been done to control that outcome. In this case, parties may safeguard the interests of the designer by explicitly deviating in the contract from the stringent liability system. The designer may also insert a limitation clause in the contract with the client. This choice of approach may have as a consequence that a compulsory insurance system is needed to cover the main risks of the designing process.

IV.C.–6:105: Handing over of the design

(1) In so far as the designer regards the design, or a part of it which is fit for carrying out independently from the completion of the rest of the design, as sufficiently completed and wishes to transfer the design to the client, the client must accept it within a reasonable time after being notified.

(2) The client may refuse to accept the design when it, or the relevant part of it, does not conform to the contract and such non-conformity amounts to a fundamental non-performance.

COMMENTS

A. General idea

This Article is based on the idea that the designer takes the initiative for the transfer of the design and that the client should accept the design unless there are serious design defects. The act of acceptance implies that the client confirms that the designer has performed the obligations in accordance with the contract. This may be done either explicitly by means of a statement or implicitly by the actual taking of the design. Minor defects and defects that can be remedied in a short period of time do not allow the client to refuse acceptance of the design. Only when defects amount to a fundamental non-performance (as defined in Annex 1) is the client allowed to refuse to accept the design.

Illustration 1

An architect has been engaged to design an underground car park. After the design has been finalised, the architect offers the design to the client. By accepting the design, the client confirms that the architect has performed the obligations under the contract.

B. Interests at stake and policy considerations

With respect to the handing over of the design, an important issue is whether the client should be allowed to reject the design in all cases. Acceptance of the design by the client is a confirmation of the fact that the design has been performed according to the contract. This is an important event for the designer; the transfer of the design to the client implies that the designer – in general – will be paid for the service. At least a substantial part of the price to be paid according to the contract will be due. This may justify a specific regulation on this topic.

The handing over of the design furthermore enables the client to check whether the design is in conformity with expectations. The client may not reject the design, unless the non-conformity of the design is a fundamental non-performance. Remedying a defective design may take some time and will raise costs, but the sooner defects are discovered, the easier it will be for the designer to correct them. Therefore, a regulation on the issue of handing over the design seems helpful. All of the legal systems studied contain some regulation of this matter.

However, it could be argued that a rule on acceptance of the design is not necessary. It might be better to have the contracting parties regulate themselves how and when the design is to be handed over to the client.

C. Preferred option

It is considered preferable to have a specific provision on acceptance of the design. The client is to accept it within a reasonable period, when the designer considers that it is fit for carrying out. This does not have to concern the design in total but may concern an independent part of the design which has already been finalised. As the designer knows the design best, the designer is to take the initiative in deciding whether the design is ready for acceptance by the client. This choice is based on the general idea of co-operation between the parties. The co-operation of the client in accepting the design or a part of it is essential to the performance of the contractual obligations. This acceptance of the design has an important meaning, as it is an act of approval that the design has been performed in conformity with the contract. However, the client is allowed to reject the design, though only in some cases. There is only room for rejection when the defects in the design or relevant part of the design constitute a fundamental non-performance. Acceptance of the design by the client enables the client to check whether the designer has performed the contract well.

IV.C.–6:106: Records

(1) After performance of both parties' other contractual obligations, the designer must, on request by the client, hand over all relevant documents or copies of them.

(2) The designer must store, for a reasonable time, relevant documents which are not handed over. Before destroying the documents, the designer must offer them again to the client.

COMMENTS

A. General idea

The designer is under an obligation to hand over all the documents concerning the design to the client, or copies of them, on request by the client. This obligation normally arises after the performance of all other contractual obligations – i.e. after the client has accepted and paid for the design. The designer may withhold performance of the obligation to hand over the documents until the client pays (III.–3:401 (Right to withhold performance of reciprocal obligation)).

If the client does not ask for the documents after having paid, the designer is obliged to store them for a reasonable time. Some standard terms for design contracts mention a period of ten years. The periods of prescription are relevant in this respect. After ten years most claims against the designer are cut off, even in the case of hidden defects: in

the case of personal injury, however, the maximum period is thirty years (III.–7:307 (Maximum length of period)). In any case, when the designer no longer wishes to keep the documents they must be re-offered to the client before being destroyed.

The Article refers to “relevant” documents. These will include the detailed design, designs used to receive permission from a public authority, certificates and expert opinions.

B. Interests at stake and policy considerations

The main question is whether the designer should be obliged to keep the relevant documents for a particular period.

Such an obligation would safeguard the interests of the client, who might need the documents for practical purposes, such as enabling a contractor to realise the design or alter the structure at a later stage, or facilitating a sale of the structure. On the other hand it might be in the interests of the designer to keep the documents, for example to protect intellectual property rights.

C. Preferred option

The reason for imposing an obligation on the designer to keep records is that the interests of the client are regarded as more important in this respect than the interests of the designer. The designer suffers hardly any disadvantage when obliged to store documents for a period. The client has a greater benefit from obtaining the records than the designer has from keeping them. Furthermore, the designer need only supply copies and can use the originals for the purpose of future tasks or for intellectual property purposes. Also, the rule is only a default rule. The parties can make other arrangements in the contract.

IV.C.–6:107: Limitation of liability

In contracts between two businesses, a term restricting the designer’s liability for non-performance to the value of the structure, thing or service which is to be constructed or performed by or on behalf of the client following the design, is presumed to be fair for the purposes of II.–9:406 (Meaning of unfair in contracts between businesses) except to the extent that it restricts liability for damage caused intentionally or by grossly negligent conduct on the part of the designer or any person for whose actions the designer is responsible.

COMMENTS

During the design process much can go wrong. If, as a result, the design becomes defective, the client may as a consequence suffer damage, often exceeding the price agreed for the designer. The designer will want to anticipate this by limiting or excluding liability. There are provisions in Book II, Chapter 9 on unfair contract terms which may in certain cases make such limitation clauses ineffective. However, these rules are of

necessity general as they have to apply to all contracts. The purpose of the present Article is to provide more clarity for the particular situation of design contracts by establishing that a limitation clause within the scope of the Article is presumed to be fair if it is used in a commercial contract, except to the extent that it restricts liability for damage caused intentionally or by way of gross negligence on the part of the designer. The presumption applies if liability is restricted to the value of the structure, thing or service which is to be made or performed following the design.

Illustration 1

An architect is engaged by a private company to design a new air terminal for the national airport. As this is an enormous assignment and the risk of damage is high owing to the public function of an air terminal, the architect manages to achieve a contractual limitation of liability to an amount less than the value of the air terminal once it has been constructed. After the air terminal has been built and has been in use for several months, a part of the roof collapses, causing huge damage, the costs of which exceed the designer's limitation of liability. Although it is a commercial contract (both parties acted in the course of their business), the agreed limitation of liability is not presumed to be fair. Whether the general rules on unfair contract terms apply must be decided without the aid of the presumption.

B. Interests at stake and policy considerations

It may be questioned whether the general rules on unfair contract terms are sufficient and whether a specific regulation for design contracts is needed. The issues are the same as in relation to processing and storage contracts. On the one hand it can be argued that there is a loss of flexibility in having a particularised rule. On the other it can be argued that there is greater certainty and more guidance.

C. Preferred option

It is preferred to have a separate Article on the limitation of liability for design contracts, in addition to the general provisions on unfair contract terms. Since this issue has been regulated in different ways in the European legal systems, the provision on the limitation of liability in this Chapter only concerns a specific type of limitation clauses in design contracts, which is needed to give guidance. It only concerns commercial contracts between two professional contracting parties, limiting the designer's liability to the value of the structure, thing or service to be designed. In the field of commercial contracts hard and fast rules are required. In other situations – i.e. when at least one of the contracting parties is not a professional (especially when the client is a consumer) – it is thought preferable to let the general rules apply.

A clause restricting the designer's liability for non-performance to the value of the structure (service or thing) is presumed to be fair and reasonable. However, this presumption does not hold in relation to intentional damage or damage due to gross negligence. Whether or not such clauses are effective must be determined on the basis of the general rules on unfair contract terms.

It should be noted that even if a term is regarded as fair under the Article reliance on it in a particular case may still be blocked by III.-3:105 (Term excluding or restricting remedies) if invoking the term would in the circumstances be contrary to good faith and fair dealing.

CHAPTER 7: INFORMATION AND ADVICE

IV.C.-7:101: Scope

- (1) This Chapter applies to contracts under which one party, the provider, undertakes to provide information or advice to another party, the client.*
- (2) This Chapter does not apply in relation to treatment in so far as Chapter 8 (Treatment) contains more specific rules on the obligation to inform.*
- (3) In the remainder of this Chapter any reference to information includes a reference to advice.*

COMMENTS

A. General idea

This Article determines the scope of application of the rules on the particular type of service contract which involves the provision of information or advice. To avoid the constant repetition of the expression “information or advice” paragraph (3) provides that references to “information” in the rest of the Chapter include references to “advice”. The concept of information in the rest of the Chapter therefore encompasses factual information, evaluative information and recommendations. Information is considered factual when it concerns material facts and the provision of the service thus merely involves the description of an observable situation. Information is evaluative when it involves a subjective judgement on the side of the provider and the evaluation of material facts. A recommendation involves the provision of advice, i.e. the suggestion to take a particular decision or, more generally, to embark on a particular course of action.

This threefold classification of information is not only necessary because it helps in determining the scope of application of the rules of this Chapter; since providing information involves heterogeneous activities, the regimes governing the types of information vary in some respects. As will be seen in the following Articles, there are specific provisions to regulate these different situations. Moreover, the performance of information contracts frequently requires the provision of a combination of different types of information. If such is the case, each type of information is governed by its specific rules.

Illustration 1

A lawyer giving legal advice will generally provide factual information about statutes and case law, an evaluation of these facts, such as a personal interpretation and their application to the situation at hand and, finally, formulate a recommendation. The rules on factual information will apply to the information about statutes and case law; the rules on evaluative information will apply to the

lawyer's personal interpretation of the facts; the rules on recommendations will apply to the formulation of the advice itself.

The provisions of this Chapter are intended to apply primarily to contracts whose main objective is to provide information. However, according to the general rules in II.-1:108 (Mixed contracts) the provisions of this Chapter also apply to obligations to inform arising from contracts whose objective is not only to provide information, but also to provide another service or indeed something else altogether. Such an obligation to inform can be either a main obligation or an ancillary one. The provisions of this Chapter do not regulate the entire contract but are applicable only to the part of the contract which relates to the supply of information. Where the provision of information is so incidental and ancillary that it would be unreasonable to regard the contract as not being primarily of another kind, the rules of this Chapter will apply in a subsidiary way – that is to say, only so far as necessary to regulate the information part of the contract and only so far as they do not conflict with the rules governing the primary part of the contract (II.-1:108 (Mixed contracts)).

Illustration 2

A service contract is concluded between a bank and a client. According to the contract, the bank is to provide a considerable variety of services to the client, including investment advice. The provisions of this chapter only regulate the obligations relating to information and not to the other services provided by the bank.

The Chapter applies not only to contracts where information is to be provided for remuneration but also, with any appropriate adaptations, to contracts where it is to be provided free. This follows from IV.C.-1:101 (Supply of a service) paragraph (1)(b).

The Chapter on Treatment contains specific rules on the obligation of the treatment provider to inform the patient. These rules regulate in particular the content of the information to be provided to the patient in order to allow the patient to give informed consent to the treatment proposed. Paragraph (2) of the Article makes it clear that these rules prevail over the rules in the present Chapter. However, the rules of the present Chapter may apply to aspects of the obligation to inform not regulated by the Treatment Chapter.

Illustration 3

A doctor failed to inform his patient of a risk of the treatment suggested, disclosure of which had to be made according to IV.C.-8:105 (Obligation to inform). The patient claims damages and has to prove that the non-performance of the obligation to inform caused the damage suffered. The causation can be proved following the provisions of IV.C.-7:109 (Causation): the patient only has to substantiate that, in the absence of the non-performance, a reasonable patient in the same situation would seriously have considered taking an alternative subsequent decision.

B. Interests at stake and policy considerations

The first policy issue is whether it is necessary to have specific rules governing information contracts. Might the provisions of Chapter 2 (Rules Applying to Service Contracts in General) be sufficient to regulate such contracts? The traditional approach is to include information contracts in the general regulation of service contracts. The modern approach, however, takes into account the specificity of contracts related to information and, more generally, intellectual services. The peculiarity of intellectual services, compared with material services, is often stressed. Thus it appears necessary, or at least useful, to have special regulations.

The second issue is whether it is possible to include advice activities in the category of contracts regulated by the Chapter. The main argument in favour of including them is that, in practice, the formulation of a recommendation, which is characteristic of the work of an adviser, very often involves the supply of information as well. Advice might even be considered as a particular kind of information.

C. Preferred option

In European laws, contracts for the provision of information are generally regarded as service contracts and provisions regarding work contracts or service contracts regulate this activity. In general, there are no specific legislative provisions governing information contracts. Solutions tend to be found in case law, which has in the last decades become abundant. Nowadays, common European principles can be derived from case law, especially with regard to information supplied by doctors, lawyers, banks, investment advisers and insurance advisers. The exception to this approach can be found in Italian law, which has specific rules for intellectual services. However, this category is broader than information contracts.

The regulation of the provision of information and that of advice is very similar according to positive law in several European jurisdictions. With the exception of some particular rules, the European legal systems do not distinguish between the two concepts.

The preferred option is to build on this modern approach, even if it is generally found in case law rather than in codes, and regard the provision of information and advice as worthy of particular regulation. Certainly there can be no doubt about the importance of the activity. Most provisions can apply to all kinds of information, but some particular provisions are designed to govern specific types of information.

There appears to be no good reason to disapply the general rules on mixed contracts. So the Chapter will regulate the obligations to inform arising from contracts dealing also with other matters. The rules will apply either in parallel or, where the provision of information is merely incidental and ancillary, in a subsidiary way. Therefore, ancillary obligations to inform will generally not be under a different regime than obligations to inform arising under contracts having information as the main objective.

D. The distinction between information and advice

Information and advice are in some respects similar and can be seen as points of a continuum. Advice can be seen as a specific type of information. Essential to the concept of advice is that it contains a recommendation to the client on a specific course of action. The aim of advice is to enable the client to make a reasoned choice from among alternatives. To that extent, advice aims at providing a person with the information which can reasonably be considered necessary for the making of a decision. It will generally include information about possible alternative courses of action and the risks of following them.

Another way of looking at the difference is that in a relationship where there is an obligation to advise, the responsibility for the quality of the choice is in a sense shifted to the adviser. The relationship between an adviser and the client is no longer a normal relationship at arm's length, but a closer relationship in which the adviser is bound to serve the interests of the client, even in the presence of conflicting interests. In some countries, a contract for advice is sometimes qualified as a fiduciary relationship implying fiduciary duties on the side of the provider. This is not the case when the provider is merely under the obligation to supply factual information.

Advice is information organised and limited in a specific way, normally by the needs of the client who wants to solve a problem. In order to find the best solution for this problem, the client needs information about possible solutions, especially about their advantages and disadvantages. The information is therefore organised around the alternatives which might possibly meet the needs of the customer and is also limited by these alternatives and needs. Moreover, in order to establish the needs of the customer, the adviser has to explore them. This may be stated somewhat differently by saying that an adviser undertakes not only to give information, but also to help the client to take a decision. These elements are not always present in cases where the agreement is simply for the supply of information.

In this Chapter, the main criterion of distinction between information and advice is whether a recommendation is to be given or not. When no recommendation is to be given the service is to be considered mere information, either factual or evaluative. Moreover, when the information provider is to recommend a specific course of action, the service is considered to be advice. In this Chapter, contracts are considered to be advice contracts 'when the provider expressly or impliedly undertakes to provide the client with a recommendation to enable the client to make a subsequent decision.' The criterion is important since IV.C.-7:104 (Obligation of skill and care) paragraph (2) and IV.C.-7:107 (Conflict of interest) state specific obligations which bind only advisers.

However, in some cases where no recommendation is given expressly, the service provided may still be qualified as advice; for example, when the information supplied is sufficiently detailed and involves the mentioning of the consequences to which each

possible course of action could lead, even in the absence of an explicit formulation of a recommendation.

Illustration 5

A professor of law gives legal advice to a client, explaining the possible legal arguments to raise in a lawsuit, without advising a specific course of action. The professor only explains the possible alternatives and the risks involved. Even if no explicit recommendation is given, such a legal consultation constitutes advice and the contract concluded between the parties is an advice contract. The adviser is under the specific obligations arising from this contract.

In other cases, a recommendation cannot be seen as advice. This is the case, for example, when a recommendation is given to the public in general and is therefore not adapted to the needs of a specific client.

IV.C.–7:102: Obligation to collect preliminary data

(1) The provider must, in so far as this may reasonably be considered necessary for the performance of the service, collect data about:

- (a) the particular purpose for which the client requires the information;*
- (b) the client's preferences and priorities in relation to the information;*
- (c) the decision the client can be expected to make on the basis of the information;*
- and*
- (d) the personal situation of the client.*

(2) In case the information is intended to be passed on to a group of persons, the data to be collected must relate to the purposes, preferences, priorities and personal situations that can reasonably be expected from individuals within such a group.

(3) In so far as the provider must obtain data from the client, the provider must explain what the client is required to supply.

COMMENTS

A. General idea

The supply of information involves a large number of actions on the side of the information provider. An information contract entails several obligations. Before the information is supplied, the provider has to know what kind of information the client needs. The first obligation of the information provider is therefore to ascertain the needs of the client. The present Article provides a particular regulation of this obligation, which in practice is very important for the provision of the service. In so far as it may reasonably be considered necessary for the performance of the service, the information provider must ascertain the purposes, preferences and priorities of the client. Moreover, according to paragraph (1) subparagraph (d) the information provider will have to

ascertain the situation of the client if this is necessary for the performance of the contractual obligations.

Paragraph (2) limits the obligation of the information provider to collecting data about the purposes, preferences, priorities and the specific situation of the client if the service is offered to a group of people. If such is the case, the information provider will be able to determine the purposes, priorities and preferences of the clients objectively, by reference to the standard of the normal member of the group. This paragraph also concerns standardised information, whose content is determined in advance by the provider. In such a case, the information provider has a more limited obligation to investigate the needs of the clients and can base the information supplied on the situation of the group of potential clients who will need the information.

Illustration 1

A company offers a mobile telephone service which provides the weather forecast, weather reports and a warning system for skiers and climbers in the French Alps. The service is not provided for the Italian and Swiss Alps. Thus, the information provider is only bound to collect information about the circumstances that apply to climbers and alpinists in the French Alps.

Paragraph (3) imposes on the provider the obligation to explain what is needed from the client.

Illustration 2

An international publisher requests a lawyer to give pre-publication advice, viz. to determine whether a biography the publisher intends to publish contains items that may lead to claims for breach of privacy. The lawyer needs to know the citizenship and domicile of the persons involved and the countries in which the book will be distributed. Determination of the applicable law is essential since legal systems may diverge on the definition of privacy and the criteria for its breach. The lawyer is to inform the publisher what kind of information is needed and the publisher is obliged to give that information on the basis of the obligation to co-operate.

B. Interests at stake and policy considerations

The first question is the extent of the data to be collected by the information provider about the purposes, preferences and priorities of the client. This depends on the kind of service offered and on the type of clients involved. It is in the interest of both parties to have a complete exchange of information before the performance of the service begins, in order to allow its correct performance. However, having to supply too much information may increase the costs for the client. Limiting the extent of information may reduce some of these extra costs.

The second question to answer is whether the information provider is to assess the circumstances under which the contract is to be performed *in concreto*, i.e. by reference

to each particular client, or *in abstracto*, i.e. by reference to a reasonable client in the same situation. There is little doubt concerning information meant to be tailor-made to the needs of a particular client. However, the duty contained in this Article may lead to problems with regard to standardised information and, more generally, with regard to information to be provided to a group of persons. Often, the information to be supplied is determined in advance by the provider, who does not take into account the needs of a particular client. Standardised information is very frequent in non-contractual relationships. However, people often enter into contracts in order to receive services which are socially desirable. In such a case, the obligation for the information provider to collect information about the purposes, the priorities and the preferences of the clients should be more limited. Moreover, when an obligation exists with regard to standardised information, it is desirable that the information provider assess the circumstances in which the service is to be performed objectively, not subjectively. In other words, the more the information is supposed to be tailor-made to the needs of a particular client, the more the circumstances in which the service is to be performed need to be assessed *in concreto*. In contrast, the more the information is standardised, the more such circumstances can be efficiently assessed *in abstracto*.

The obligation to assess the circumstances in which the service is to be performed is widely accepted in the European legal systems. When the information to be provided is not standardised, the information provider has to deliver information tailored to the specific needs and situation of the client. This obligation requires the provider to make a preliminary assessment before providing the service. This obligation is generally deduced from the general provisions on the standard of care. The supply of a service which is not tailored to the needs and situation of the particular client is, in such a case, not given in conformity with the standard of care.

C. Preferred option

The preferred option is to impose an obligation to collect preliminary data but to limit the amount of data to be collected to what may reasonably be considered necessary for the proper performance of the service. This criterion allows the parties and the judge, in assessing liability, to determine the amount of preliminary data to be collected by the information provider or to be exchanged by the parties on a case-by-case basis. In doing this, one will need to turn to a subjective standard when the object of the contract is to supply tailor-made information and to an objective standard with regard to standardised information, i.e. information whose content is determined in advance by the provider.

As a consequence, with regard to standardised information it is up to the client to choose a service provider who offers a service which corresponds with the client's needs. Providers of this kind of information are not under the obligation to collect data about the needs of each particular client before performing the service. They offer to the public a specific service and it is up to the client to determine what is needed, before requesting the service. Thus, the data to be collected relate to the purposes, preferences, priorities and personal situations which could reasonably be expected in relation to persons in the relevant group.

IV.C.–7:103: Obligation to acquire and use expert knowledge

The provider must acquire and use the expert knowledge to which the provider has or should have access as a professional information provider or adviser, in so far as this may reasonably be considered necessary for the performance of the service.

COMMENTS

A. General idea

It is up to the information provider to acquire and use the expert knowledge necessary for the proper performance of the obligations under the contract.

Illustration 1

A rich businessman, who has financial interests in various countries and members of his family living abroad, requests the advice of an estate planning lawyer with a view to minimising taxes for his heirs. In order to be able to give the advice, the lawyer must be knowledgeable and collect information about inheritance tax law, marital law, succession law and international private law in the jurisdictions connected with the case.

The phrase ‘may reasonably be considered necessary for the performance of the service’ primarily refers to the result expected by the client and agreed upon by the parties. In other words, the input necessary depends on the output agreed upon. Defective input will generally lead to defective output, and thus to liability of the information provider on the basis of the provisions regulating the output. However, the collection and use of particular expert knowledge is an obligation in itself. Failure to perform it may lead to independent sanctions.

The main goal of this provision is therefore to allow the client to react as soon as the client becomes aware of the information provider’s use of improper, incomplete or defective expert knowledge; the client does not have to wait until the performance of the service has been completed.

B. Interests at stake and policy considerations

There is no doubt that a professional information provider needs to acquire and make use of the expert knowledge necessary for the performance of the service. The main issue is the amount of knowledge needed in order to live up to the standard of care required. What should be the extent of the obligation? What criterion should be used to determine that extent?

Requiring too much expertise from all information providers will lead to costs which will often be unnecessary for the provision of a good service. In some cases, this may even

discourage providers from performing the service requested, because it may become too risky for them: they may too easily be held liable. On the other hand, if information providers are allowed to provide services regarding matters in which they are not sufficiently competent, the client may be seriously harmed. A middle course needs to be found.

The way to establish the extent of expert knowledge information providers need to have and to apply can be difficult to determine. In the sciences, the reference to the state of the art of the discipline at the moment of the provision of the service can be considered to be a guideline. This is probably not possible for other fields or practices. In such cases, reference may be made to the prevailing opinions in the community in which the information provider works or to deontological principles.

C. Preferred option

The preferred option is to impose an obligation but to limit it, first, by referring to the expert knowledge to which the provider has or should have access as a professional information provider or adviser and then by using the criterion of “in so far as may reasonably be considered necessary for the performance of the service”. This will enable courts to take into account the particular circumstances of each case and to refer to the general obligation of skill and care under IV.C.–2:105 (Obligation of skill and care) and to the particular obligation of skill and care for information providers and advisers under IV.C.–7:104 (Obligation of skill and care) paragraph (1)(b).

Where the information to be provided is factual information, the obligation under the present Article will often be overridden by the obligation under paragraph (2) of IV.C.–7:105 (Conformity) to provide correct information. This means that the contractual obligation of the information provider will not be performed if the expert knowledge passed on to the client is incomplete or incorrect, regardless of the fact that the provider has acted with reasonable care and skill in researching the expert knowledge.

Illustration 2

A client requests a law firm to make an inventory of the current law on employer liability. The law firm consults the LEXIS database. If some relevant cases are lacking in that database, due to which the information provided to the client is not correct or is simply incomplete, the firm has not performed its contractual obligation, regardless of the fact that it acted with reasonable care and skill in collecting expert knowledge and in deciding to consult the LEXIS database.

IV.C.–7:104: Obligation of skill and care

- (1) The provider’s obligation of skill and care requires in particular the provider to:***
- (a) take reasonable measures to ensure that the client understands the content of the information;***

(b) act with the care and skill that a reasonable information provider would demonstrate under the circumstances when providing evaluative information; and
(c) in any case where the client is expected to make a decision on the basis of the information, inform the client of the risks involved, in so far as such risks could reasonably be expected to influence the client's decision.

(2) When the provider expressly or impliedly undertakes to provide the client with a recommendation to enable the client to make a subsequent decision, the provider must:

(a) base the recommendation on a skilful analysis of the expert knowledge to be collected in relation to the purposes, priorities, preferences and personal situation of the client;

(b) inform the client of alternatives the provider can personally provide relating to the subsequent decision and of their advantages and risks, as compared with those of the recommended decision; and

(c) inform the client of other alternatives the provider cannot personally provide, unless the provider expressly informs the client that only a limited range of alternatives is offered or this is apparent from the situation.

COMMENTS

A. General idea

This Article provides further specification of the information provider's obligation of skill and care. It is the core of the regulation of information contracts.

The information provider is under an obligation to provide clear and understandable information, to act with reasonable care and skill with regard to evaluative information and to inform the client about risks. Moreover, the information provider who provides the client with a recommendation, i.e. the adviser, is under the obligation to mention alternatives.

Since the purpose of the information provided is to enable the client to make an enlightened subsequent choice, the information must be understandable and, if in writing, legible. According to paragraph (1)(a), the provider is to take reasonable measures to ensure the client understands the information. The more the provider gives the client the impression that the information is expressly tailored to the client's individual needs, the heavier the obligation in this respect. If, however, only a very limited service is given, especially if the information is given in a standardised form without actual contact between the parties, the provider's obligation to make sure a particular client understands the information is more limited.

Paragraph (1)(b) is the core of the Article. It provides that the information provider is to "act with the care and skill that a reasonable information provider would demonstrate under the circumstances when providing evaluative information".

Illustration 1

An adviser advises a client to make a particular long-term investment. After ten years, it turns out that another investment would have been more profitable for the client. The adviser is not liable, unless it is shown that he or she did not act with reasonable care and skill.

According to paragraph (1)(c), the information provider is to inform the client about the risks involved in the various courses of action available. The obligation to inform about risks exists when the client is expected to make a subsequent decision on the basis of the information received. It is generally accepted that the information provider has to inform the client about the risks involved in the latter's subsequent decision. This is considered to be one of the essential features of the obligation to inform.

When the information provider provides the client with a recommendation, i.e. in the case of advice contracts, special provisions are to be found in paragraph (2). The adviser's main obligation is to recommend a specific course of action from among the alternatives available. In order to do so, subparagraph (a) states that the adviser is to make a skilful analysis of the information gathered and, on the basis of that analysis, recommend a particular course of action to the client. In the analysis, the adviser must take into account all the alternatives at hand and the risks they involve. These alternatives may include not doing anything at all.

Illustration 2

A patient can decide not to undergo treatment; a client of a lawyer can decide not to sue; an adviser on company strategy can advise against the merger with another company. If not doing anything is the best alternative for the client, the adviser should so advise the client.

Subparagraphs (b) and (c) impose on the adviser an obligation to inform the client of the alternatives available. However, as a rule the information provider is not under an obligation to mention alternatives to the client. Even when the adviser is in a position to provide one of the alternatives personally, the client should be informed about the alternatives the provider cannot supply, unless the information provider expressly informs the client that only a limited range of alternatives is offered or this is apparent from the situation.

Illustration 3

An insurance broker does business with only a limited number of insurance companies, and recommends to his client the best alternative from among the insurance policies offered by those companies. He is obliged to disclose this situation to the client. This is also the solution of the EU Directive on insurance brokerage.

B. Interests at stake and policy considerations

Several issues arise from this provision. If the existence of an obligation to give clear and understandable information is not debated, the other obligations of the information provider involve difficult choices and the reconciling of conflicting interests.

With regard to paragraph (1)(b), the issue is to determine whether the information provider is under an obligation of best efforts only or under an obligation to guarantee the result as envisaged by the parties by providing evaluative information (for discussion of the issue regarding factual information, see Comment B to IV.C.–7:105 (Conformity)). It is in principle difficult for the information provider to guarantee the exactness of evaluative information. This is usually the case when the information is not yet available or concerns a future event. For every kind of forecast or prediction it is difficult for the information provider to guarantee the exactness of the information.

Illustration 4

A weather forecast agency predicts sunshine for the next day. However, a storm rages that day. The agency is not liable if it acted with the care of a professional of the same profession.

Illustration 5

A bank willing to lend money to a company requires a mortgage on a building belonging to the debtor. The bank requests a valuation of the building. The valuer is not under an obligation to guarantee the bank that it will effectively receive the valuation amount in case of enforcement of the guarantee. The bank must take the risks of market developments. The valuer's obligation is only to perform a valuation with reasonable care and skill.

Besides the supply of information about future and unknown events, i.e. predictions, more generally the question arises whether the information provider ought to be under an obligation of best efforts in all cases in which the information is not factual, but evaluative. When information has to be processed by the provider in order to perform the contractual obligations, it is usually unfair to impose on the provider a guarantee of the correctness of the information.

Illustration 6

An estate agent is requested to provide information about the value of a villa. In order to do so, the estate agent has to process many factual data (surface, neighbourhood, recent sale prices of similar estates in the area ...). This involves several hazards, and the agent cannot guarantee that the client will find a buyer at the valuation price given. The agent is under an obligation of best efforts, and is liable only if the required standard of care was not met.

As in the case of the provision of evaluative information, the adviser cannot guarantee that the result expected by the client will be achieved if the client acts on the

recommendation. In other words, it is not possible to require from a professional adviser that the course of action advised is the best one for the client.

With regard to the obligation to mention the risks, the main issue is to assess precisely the extent of the risks that the information provider is to disclose. Since the information is provided in order to allow its recipient to take a subsequent decision, it seems logical to link the risks directly with the subsequent decision in such a way that only the risks that could reasonably be expected to influence the client's decision are to be disclosed. Since the information provider does not necessarily know what kind of risk might influence the decision of the client, it might be said that this solution places the provider in a position of uncertainty. It might be suggested that it would be better to specify in advance the risks to be disclosed. However, this solution would be possible only in relation to some types of information; for example in relation to the risks of certain medical treatments, where clear statistics exist, it might be possible to require the disclosure of those risks which turn up in statistics with a particular frequency. This solution would, on the other hand, be difficult to apply to other areas where such a calculation of frequency cannot be made and where it is impossible to regulate any particular situation. For this reason, it may be preferable to have a more general provision.

The question whether the adviser should be under an obligation to mention alternatives is not really an issue, as this principle is widely accepted. The main question is to determine whether the adviser should be bound to mention alternatives the adviser cannot provide personally. This situation occurs when the adviser also provides other kinds of services. This is frequently the case in the field of insurance advice. An argument in favour of such an obligation would be the faith placed in the adviser by the client, who may not know that the adviser may not be the best qualified person to execute the service. For this reason an adviser is, in principle, obliged to mention alternatives. This may in particular be the case if a specialisation has been developed within a particular profession. It is generally accepted that the standard of care a doctor has to meet may require the doctor (e.g. a general practitioner) to refer patients to another doctor (e.g. a specialist). On the other hand, in some situations the provider of a good or service is not obliged to refer to a competitor who can deliver better goods or services.

The duty to provide clear and understandable information is generally accepted in all European legal systems as part of the general standard of care required from the information provider. The case law is generally to the effect that the information provider is merely under an obligation to make the best efforts to provide correct information. Strict liability or obligations of result are generally not found in this area.

Several techniques are used in European jurisdictions to determine the risks to be disclosed: a priori determination, causation reasoning and standard-of-care reasoning. Apart from the type of legal reasoning applied, legal systems also diverge with regard to the determination of the extent of the risks that have to be mentioned. Especially concerning medical treatment, some legal systems impose on the provider the duty to inform the other party about all possible risks, even those that materialise exceptionally.

This is, for example, the case for French law. In other legal systems there is no *a priori* statement of the risks which have to be disclosed. The risks to be disclosed are those that may influence the decision of the client (Germany, Austria). In yet other systems, the determination is made by applying a normal standard-of-care reasoning; the risks to be disclosed are the ones that a reasonably competent and skilful professional would have disclosed (England). Reference is made to professional literature and codes of ethics to determine what a reasonable professional would have disclosed.

No common position is to be found in European legal systems with regard to the obligation to mention alternatives. If the principle of this duty seems to be widely accepted for the adviser, there is divergence with regard to the information provider who does not provide a recommendation. The most important divergence probably concerns the duty of the adviser to mention alternatives that the adviser is not able to provide personally.

D. Preferred option

With regard to evaluative information, in this Article the obligation of best efforts is opted for. The information provider must provide the service with reasonable care and skill.

In paragraph (1)(c), causation reasoning is followed in order to determine the extent of the risk to be disclosed. The information provider only has to mention risks the awareness of which could reasonably influence the other party's choice. Specific provisions exist with regard to information about risks in the treatment Chapter (IV.C.–8:105 (Obligation to inform)). However, according to paragraph (2) of this Article, the regime of the duty of the service provider to inform about therapeutic risks is governed by the provisions in the present Chapter.

The obligation to mention alternatives is imposed only on the adviser, not on the information provider who does not give a recommendation to the client. Concerning alternatives the adviser cannot personally provide, paragraph (2)(c) states an in-between solution, providing that in principle the adviser is to mention such alternatives. However, the adviser can exclude the obligation to mention such alternatives by explicitly stating that the advice given concerning only alternatives the adviser can personally provide or a limited range of alternatives provided by others. This statement must be given, as soon as the adviser comes into contact with the client. Moreover, sometimes it is obvious that the professional will only advise the client about alternatives the adviser can personally provide. If this is the case, there is no need to make the statement mentioned above.

Illustration 7

A private individual requests a loan for the acquisition of a piece of an estate. The bank will only advise the potential client on the various types of loans it can offer him. The bank is not obliged to advise in favour of loan contracts offered by other banking institutions.

This Article contains default rules. The parties may agree that the information provider is to guarantee the exactness of the information even in providing evaluative information or advice. The standard of care can also be lowered by contractual stipulation. Frequently a client chooses not to be informed about the risks of a specific course of action.

Illustration 8

A patient decides not to be informed about the risks and the alternatives of the treatment recommended. In other words, the patient entirely trusts the physician and, in fact, asks the latter to take the decision in his place. This wish must be followed by the treatment provider and, as a consequence, his duty to inform is alleviated.

IV.C.–7:105: Conformity

(1) The provider must provide information which is of the quantity, quality and description required by the contract.

(2) The factual information provided by the information provider to the client must be a correct description of the actual situation described.

COMMENTS

A. General idea

Paragraph (1) states the obvious – namely that the information provider is obliged to provide information of “the quantity, quality and description required by the contract”. What the contract requires will depend on its terms and may involve a question of interpretation. There is normally little difficulty in relation to the quantity and description of the information required. So far as the quality of the information is concerned, in the case of evaluative information or advice there will normally be no obligation to achieve a specific result envisaged by the client, such as perhaps a completely accurate valuation or prediction. This will follow from the application of IV.C.–2:106 (Obligation to achieve result) because of the inherent risks involved in evaluations and predictions. The contract, properly interpreted, may impose no obligation at all relating to the quality of the information to be provided, in which case the obligation of skill and care will be the only relevant obligation in this respect. The obligation will simply be one of means, not result. Alternatively, the normal default rule on quality may apply, in which case the quality required is that “which the recipient could reasonably expect in the circumstances”. (II.–9:108 (Quality)). This will normally be something within the range of what would be provided by a competent information provider exercising the normally required degree of skill and care.

As a consequence, in the case of bad performance of an obligation to provide evaluative information or advice the liability of the information provider will often be determined by

reference to the default rules on the obligation of skill and care. In the case of absence of performance or incomplete performance, the present Article applies.

Illustration 1

A publisher contracts with a lawyer to give pre-publication advice as to whether two manuscripts might infringe rights to privacy. The lawyer is under an obligation to supply the service requested, viz. to determine whether the books contain items that may lead to claims for breach of privacy. This is an obligation of result. The lawyer is liable if he does not perform the contractual obligations or if he performs them only partially, e.g. by providing advice regarding only one of the manuscripts, or if he provides advice of the wrong description, e.g. advice on defamation instead of advice on breach of privacy rights. On the other hand, after the service has been provided the way in which it was provided is assessed by reference to the due standard of skill and care.

Paragraph (2) introduces a particular provision with regard to factual information as opposed to evaluative information or advice. In the case of factual information, the information provider is to guarantee, on principle, the correctness of the information provided. There is an obligation to achieve this result when the information is merely factual.

Illustration 2

A lawyer is contracted to provide information about the latest case law of the Supreme Court on a particular issue. If the information is wrong, e.g. if a recent reversal of the line of the case law is not mentioned, the provider is in breach of contract, whether the incorrectness of the information is the consequence of the negligence of the information provider in collecting or supplying that factual information or not.

B. Interests at stake and policy considerations

The main issue here is whether the provider who supplies factual information is to be obliged to guarantee its correctness or will be liable only if it is proved that there was a failure to come up to the required standard of skill and care. In Comment B to the preceding Article, it was explained that it was difficult to accept that the information provider who supplies evaluative information should be liable merely because the information is incorrect. One reason is that evaluative information may amount to a prediction, which in itself means uncertainty. Moreover, evaluative information, when it is not a prediction, is in itself an opinion, whose correctness is not verifiable. It is also arguable that the correctness check cannot be applied to an opinion. These arguments do not apply when the information provider is to supply information of a purely factual nature, i.e. when the service concerns facts which can be collected and verified with certainty. If the information is factual, it is generally easy for it to be checked and its provision does not involve any uncertainty. In such a case, the client will expect to receive correct information, not wrong and misleading information.

European legal systems do not expressly follow the distinction that is made in this Chapter between factual and evaluative information. However, in many jurisdictions it appears that a breach of the obligation of skill and care is more easily found when objective information is provided. Moreover, in situations concerning the mere provision of factual information, an important trend in legal literature is of the opinion that the information provider should guarantee its accuracy.

C. Preferred option

The preferred option is that in the case of factual information the information provider is to guarantee the correctness of the information. The reason is that there is no uncertainty involved in the performance of such an obligation, and the information is easy to check. The contracting parties can expect achievement of an accurate result. Indeed, when factual information is obtained contractually, the customer will generally rely on its exactness. As a consequence, the information provider is liable when the client proves that the factual information provided is incorrect. The information provider can be relieved of liability only by proving that the incorrectness of the information is due to an excusing impediment within the meaning of III.–3:104 (Excuse due to an impediment). The information provider, on the other hand, is not excused by proving that the service was performed with reasonable care and skill.

Paragraph (2) is a particularisation of IV.C.–2:106 (Obligation to achieve result) because a reasonable client requesting objective information would have no reason to believe that there is a substantial risk that the information provided would be incorrect.

D. Distinction between evaluative and factual information

The question may arise whether the information to be provided is factual or evaluative.

Illustration 3

Information exchanged between banks on the creditworthiness of clients is a delicate issue. When creditworthiness only concerns the financial situation of the debtor at the time of the provision of the information, the information provider guarantees the correctness of that information: it is considered to be factual. However, when future creditworthiness is concerned, the information is considered to be evaluative, i.e. it concerns the processing of actual information to predict the future situation of the debtor and its capacity to reimburse his debts. In such a case, the information provider is merely under the obligation to act with reasonable care and skill.

Even if the information provided is factual, that information may not always give a precise answer to the client's problem. An example is a lawyer's knowledge of positive law. If there are uncertainties about the interpretation of a court case or of a statute, the information provider must inform the client of that. Difficulties in interpretation are in themselves facts that must be disclosed.

Illustration 4

A tax adviser is requested to explain the criteria for exemption from plus-value taxes on the resale of houses by non-residents. It appears that the tax authorities and the courts do not treat the improvements made to houses in the same way. The tax adviser in answering must make this difference in opinion clear to the client.

However, even if purely factual information was to be provided it is sometimes impossible for the provider to guarantee its correctness. Even if the information requested by the client exists, it cannot always be collected in its entirety or be verified. If this is the case, the provider is to notify the client that the exactness of the information cannot be guaranteed. The provider is to notify the client on becoming aware of this circumstance. Sometimes the provider is in the position to inform the client before the performance of the service begins. In other situations, the uncertainty about the reliability of the information collected is known only after verification, and therefore after the performance of the service has started. Such is the case concerning information about the creditworthiness of a merchant. The provider is relieved of this obligation to notify only when it is self-evident that the exactness of the information cannot be guaranteed. Here IV.C.-2:102 (Pre-contractual duties to warn) and IV.C.-2:108 (Contractual obligation of the service provider to warn) apply.

Illustration 5

A detective agency is engaged by a woman to assess the fidelity of her husband. After several weeks of surveillance and investigation, the detective agency does not find any evidence of infidelity. Even if this is the provision of factual information, it is evident that the agency is not liable merely because it did not discover the truth. The betrayed woman must prove that the agency acted negligently.

The Article contains default rules. The parties are free to decide precisely on the nature and the content of their obligations. The existence of default rules is, however, of relevance in information contracts, because in practice such contracts are often concluded orally and the parties do not precisely describe the obligations of the information provider.

IV.C.-7:106: Records

In so far as this may reasonably be considered necessary, having regard to the interest of the client, the provider must keep records regarding the information provided in accordance with this Chapter and make such records or excerpts from them available to the client on reasonable request.

COMMENTS

A. General idea

The purpose of the rule is two-fold. The first purpose is to give the client the opportunity to check what the information provider has done under the contract and, more precisely, the steps taken in performing the contractual obligations. In order to evaluate the way the service has been performed, the client may need to know the way in which the information provider organised the performance.

Illustration 1

The managing director of a company engages an auditors' firm to make a valuation of a target company for the purpose of its acquisition. Since there are several methods in corporate finance for determining the value of a company, the client is entitled to request the auditors to disclose the method applied to determine the value of the company and the elements taken into account.

The second purpose of this Article derives from the consideration that, when dealing with liability for non-performance of an obligation to inform and to advise, the burden of proof is of great importance. This Article is an attempt to solve the issue of burden of proof. With regard to the non-performance, the allocation of the burden of proof is not stated explicitly in the Article, but can be derived from it. Since the information provider is under an obligation to account for what has been done, there will in effect be an obligation to prove that the contractual obligations were performed and the way in which they were performed. Such an obligation may also become relevant in the case of litigation. At this stage, the information provider is bound to supply evidence of the way the contractual obligations were performed. On the other hand, this provision does not impose on the information provider an obligation to prove that there was no failure to perform any obligation arising from the contract; the obligation is merely to provide the elements necessary to assess this.

Illustration 2

The managing director of a company engages an auditors' firm to make a valuation of a target company for the purpose of its acquisition. On the basis of this valuation, the target company is purchased. Shortly after the acquisition, the value of the company turns out to be much lower than the price paid and the value assessed by the auditors. In the litigation between the client and the auditor, the latter is to inform the court about the elements of the valuation and the method applied.

B. Interests at stake and policy considerations

The issue whether or not to shift the burden of proof is a controversial one. Placing that burden on the client without further consideration will result in a situation in which clients will want to file claims they cannot substantiate. It will indeed be very difficult for a client to prove that the information requested was not received. Very often the

information is delivered orally and no written evidence exists. Even if the information was supposed to be supplied in writing, it may still be problematic for the client to prove that the contract was not performed. On the other hand, even if the client received the information or the advice in writing, it may be difficult to prove a failure of the provider to perform the contractual obligations if the client does not have information on how the information provider carried out the task.

On the basis of these arguments, one may argue that the burden of proof should be imposed upon the information provider. However, this would not justify a complete reversal of the burden of proof. The negative proof (*probatio diabolica*) argument supports a shift of the burden of proof with regard to effective performance of the contractual obligations and with regard to the way they have been carried out. This argumentation does not justify a reversal of the burden of proof on whether there has been a failure of performance. In fact, as soon as the client has information on all the elements needed to evaluate the performance of the service, the burden of proving that the information provider did not perform the obligation of skill and care may appropriately be placed on the client. Moreover, placing the burden of proof entirely on the information provider may place the provider in a very unfavourable situation and, as a consequence, may lead to a refusal to perform the service requested. This is the case especially if the burden of proof is completely shifted and the provider is under the obligation to prove that the performance was in conformity with the required standard of skill and care.

Finally, there is also an argument of legislative policy that might favour a shift of the burden of proof. This is related to the preventive role this may have when the provider has to prove performance of the obligation. Facilitating the assessment of the liability of the information provider is a tool to force the information provider to effectively supply the information the client needs to decide whether the contractual obligation has been duly performed. Legal systems have been very sensitive to this argument especially with regard to medical information and advice and the issue of informed consent.

C. Preferred option

For the reasons given above, the Article imposes on the information provider an obligation to keep records regarding the information provided to the client and make them available to the client on reasonable request. In effect, therefore, the provider is under an obligation to give account for the performance of the service. In particular, it is up to the provider to prove that the information was supplied and to make clear how the information was collected and processed. The proof of incorrect performance of the service remains on the client.

The Article can be applied differently depending on whether the provision of information is the main object of the contract or merely an ancillary obligation. The obligation to keep records and make them available does not generally involve extra efforts when the provision of information is the main obligation. If this is the case, the provider will often give account simultaneously with providing the service.

Illustration 3

A client receives legal advice from a lawyer. It is a written document of 50 pages. It turns out that the course of action recommended is not the best one for the client and leads to a substantial loss of money. To recover damages, the client will have to prove that the advice was not based on a skilful analysis of the information gathered.

In this case, the client has all the elements needed to try to prove that the provider did not perform the obligation of skill and of care.

On the other hand, with regard to ancillary obligations, the performance of the obligation will more often require a particular action on the side of the information provider. In such a case, the client usually receives only the outcome of a complex effort on the part of the provider, i.e. information or a recommendation, without details about the reasons and the elements considered in the process up to the conclusion. Moreover, ancillary obligations to inform are usually fulfilled orally.

Illustration 4

A patient claims he did not receive adequate information from his physician and that, as a consequence, his consent to the treatment cannot be classified as informed consent. Since it is impossible for him to indicate what information he did receive as it was delivered orally and since he cannot explain why he was advised to undergo that treatment, the physician has to produce the relevant records concerning the giving of the information.

This Article seems to be in conformity with the actual practice of many providers of information services. The Article will probably have the practical consequence of inducing information providers to pre-establish a written document. This written document will prevent disputes and litigation on proof issues.

Illustration 5

A civil-law notary, after having provided advice for the drafting of a contract that the client does not wish to follow, requires from the client a letter of confirmation stating that the client received the information and the advice and decided to choose a different course of action. By this means the notary has proof of the fulfilment of the obligation to inform and advise.

The Article contains a default rule. Contracting parties may agree to relieve the information provider of the obligation to keep records and make them available. This stipulation may be of use in case of confidentiality, such as when the information provided includes particular know-how. In such a case the client may prefer there to be no records in the hands of anyone else.

IV.C.–7:107: Conflict of interest

(1) When the provider expressly or impliedly undertakes to provide the client with a recommendation to enable the client to make a subsequent decision, the provider must disclose any possible conflict of interest which might influence the performance of the provider's obligations.

(2) So long as the contractual obligations have not been completely performed, the provider may not enter into a relationship with another party which may give rise to a possible conflict with the interests of the client, without full disclosure to the client and the client's explicit or implicit agreement.

COMMENTS

A. General idea

This Article provides that the adviser – i.e. the information provider who undertakes to provide the client with a recommendation – is under an obligation of loyalty. In advising the client, the adviser is to act in the best interest of the client and in the case of a conflict between the provider's own interest and that of the client, the latter must prevail. This provision does not apply to information providers who limit themselves to providing their clients with factual or evaluative information without recommending a particular course of action. Taking into account the obligation of loyalty, paragraph (1) imposes on the adviser an obligation to disclose any conflict of interest that might influence the performance of the provider's obligations under the contract. If the adviser fails to disclose a situation of conflict of interest, this amounts to non-performance of an obligation, thus allowing the client to resort to a remedy such as damages or, if the non-performance is fundamental, termination of the contractual relationship.

Illustration 1

Insurance advisers frequently advise clients in favour of products that they provide themselves or that generate a particular advantage for them, such as extra fees. For example, the insurance broker who has privileged relations with only a few insurance companies will be very much inclined to advise in favour of products offered by these insurance companies and not by those of other companies, even if their products are more suitable to the needs of the client. Such a situation will have to be disclosed to the client.

Illustration 2

A bank advises one of its clients to invest in the shares of a company on the ground that the company is financially sound and that it would make a good investment, without disclosing that the company in question is in debt to the bank. The bank has its own interest in advising such an investment, which will financially benefit it. In this case, there is a conflict of interest that has to be

disclosed. (see *Woods v. Martins Bank Ltd.*, [1958] 3 All ER 166; [1959] 1 Q.B. 55)

Paragraph (2) prevents the adviser from entering into a relation with another party that has an interest conflicting with that of the actual client. The adviser may only do so after full disclosure of the potential conflict of interest to the actual client and the client's agreement. Such an agreement may be explicit or implicit.

B. Interests at stake and policy considerations

The question whether the information provider is bound to act in the best interest of the client and to disclose a potential conflict of interest is very controversial. There are two questions. First, is such an obligation needed and, secondly, should all or only some information providers be bound by such an obligation?

The consequence of the imbalance of competence and knowledge between the parties to an information contract is that the position of the client is usually very weak. It is, therefore, necessary to prevent the information provider from not performing the contract in conformity with the interest of the client. The personal interest of the information provider should not determine the content of the service provided. The interest of the client is to have the possibility of appreciating the service received in the light of full knowledge of the situation. Information provided by an independent provider will involve less insecurity and risk for the client than information provided by a provider in a situation of conflict of interest. In other words, imposing the obligation to disclose a potential conflict of interest allows the client to decide whether or not to run the risk to take a decision on the basis of information given by a provider in a situation of conflicting interests.

However, the risk that the client runs seems to be less important when the information provided is factual. The more the information tends to be evaluative or even leads to a recommendation, the more the risks the client runs matter. Indeed, evaluation of the quality of the information is easier in the case of factual information. However, when it concerns expressing an opinion or giving a recommendation on a particular course of action, the client is dependent on the information provider.

C. Preferred option

According to paragraph (1), the adviser is under an obligation to disclose such a situation to the client. The motivation behind this provision is that the adviser is under a general duty to act in the best interest of the client. When personal interests of the adviser are involved, there is a risk that these affect the interests of the client. Disclosure will allow the client to evaluate the risks of letting a provider in the situation of conflict of interest perform the service. If such interests are not disclosed, the client may resort to the remedies available for non-performance of an obligation. Such is the case even if it has not been proved that the adviser did not act in conformity with the required standard of skill and care or gave incorrect advice; it is sufficient to prove that, at the time of the

performance, the adviser was in a situation of conflict of interest and that the damage suffered is caused by the service provided.

Such a provision is considered essential with regard to contracts concerning the provision of advice. Such contractual relations are generally based on confidence and can often be regarded as fiduciary relationships. For this reason, the line is drawn between, on the one hand, the provision of advice – where a conflict of interest must be disclosed – and, on the other hand, the provision of factual and evaluative information – where the provider is not bound to disclose a situation of conflict of interest.

IV.C.–7:108: Influence of ability of the client

(1) The involvement in the supply of the service of other persons on the client's behalf or the mere competence of the client does not relieve the provider of any obligation under this Chapter.

(2) The provider is relieved of those obligations if the client already has knowledge of the information or if the client has reason to know of the information.

(3) For the purpose of paragraph (2), the client has reason to know if the information should be obvious to the client without investigation.

COMMENTS

A. General idea

This Article deals with the possibility that the information provider might invoke the client's competence as a defence for excluding or at least limiting liability. According to this provision, the mere fact that the client has some knowledge in the field in which the information is provided is not a defence for the provider. The fact that the client is assisted by another competent professional is not a defence either.

The only defence for the information provider is to prove that the client had concrete knowledge of precisely the information that was not provided and should have been provided. This defence also exists when the client had reason to know the information in question. A client has reason to know the information when such information should be obvious without investigation.

Illustration 1

An experienced CEO of a multinational group requests the advice of his lawyers with regard to the plan to acquire the shares of companies quoted on foreign markets. The advisers do not inform the client about the obligation to pay higher plus-value taxes on reselling abroad. The fact that the client is an experienced businessman, with knowledge about stock market operations, is not a defence

relieving the advisers of liability. The advisers would have to show that the client knew of this fact or that it should have been obvious without investigation.

The reference to the absence of investigation stresses the fact that the duties of the information provider are not modulated according to the existence of an obligation of the client to acquire information. The existence of such an obligation may involve contributory negligence, as will be explained in Comment E.

B. Interests at stake and policy considerations

If the client is competent or has the assistance of other information providers, the question arises whether that assumed competence influences the information that is to be provided.

Assuming that the obligation of the information provider is not alleviated by the competence of the client or the assistance of another information provider would have the advantage of legal certainty and clarity: the information provider would know that there was always an obligation to inform the client fully. Such a rule may also be regarded as very client-orientated. Several other arguments may be put forward in favour of this option. First of all, even a partly competent client may not always be the best judge of his or her own affairs. The client, appreciating that problem, might even have asked for the service for exactly that reason. Secondly, the contrary solution would incite the information provider to be passive in the presence of a professional or assisted client. A third argument, which primarily relates to the situation in which the information is the main object of the contract, is that if the client had wanted less than full information, the contract could have so provided. A fourth argument rather relates to the situation in which the obligation to inform and to advise is an ancillary obligation. In such a situation, with regard to the ‘borrowed’ knowledge of the third information provider, it should be mentioned that the client runs the risk of the two information providers blaming each other; both stating they thought the other information provider had already given the information.

However, on the other hand the modulation of the content of the obligation according to the competence of the client seems more economical. Gathering and supplying information adds to the costs of the service, whereas – if the client is competent – these extra costs are probably incurred unnecessarily.

C. Comparative overview

The solutions adopted in the Member States of the European Union seem to clash at this point. Under French law, case law since 1995 has taken the position of not allowing the obligation of the information provider to be affected by the fact that the client is competent in the relevant field or is being or has been informed by a third information provider, unless it is proved that the client had knowledge of the concrete information. French doctrine summarises this line of the case law by stating that the obligation to inform and to advise is not relative, according to the competence of the client, but absolute. German case law has consistently ruled that an information provider does not

need to inform the client about what the client already knows. But here and in other countries, it is less clear whether the mere competence of the client or the presence of other information providers influences the duties of the information provider.

Case law can be found especially in the field of financial information. According to the traditional line of the case law in many European legal systems, the supplier of financial services is not bound to inform the competent client, especially the one who is experienced in operations on the stock exchange market. This solution will probably partially change as a consequence of the future implementation of EU Directive 2002/65 on distance marketing of consumer financial services, which introduces informational duties. The Directive follows the traditional definition of the consumer, i.e. the natural person who acts for purposes outside his or her trade, business or profession. By rejecting a definition of 'consumer' containing reference to the criterion of competence in the field of the contract at hand, the Directive excludes defences on the basis of the client's competence, thus implying that informational duties arising from the Directive are to be performed regardless of this fact.

D. Preferred option

An intermediate position is preferred. In principle, the information provider has to provide full information even if the client is assisted by a third information provider or has some degree of competence.

Illustration 2

A solicitor consults a civil-law notary concerning a personal inheritance matter. The civil-law notary, in charge of the formalities of the settlement of the estate does not inform the solicitor of the time limit for deciding on acceptance or refusal of the succession. The time limit elapses without decision and the solicitor is then considered to have renounced the succession. The fact that the client is a lawyer is no defence for the civil-law notary.

As a rule, the obligation to inform and to advise remains unaffected by the presumed competence of the client or by the fact that information is provided by others. However, the economical argument in favour of limiting the obligation is taken into account if the client has not merely theoretical but also concrete knowledge of the information the provider is to supply, or the information provider could reasonably expect the client to have such concrete knowledge.

Illustration 3

A lawyer, acting for his private purpose, requests a civil-law notary to draft a contract for the purchase of an apartment along lines suggested by him, stating that he has already sorted out all the issues concerning tax law and civil law. In this case, the civil-law notary can reasonably rely on the lawyer's statement and the lawyer cannot claim damages for not having been fully informed and advised

not to choose such a course of action. The reason is that the civil-law notary can assume his client has the concrete knowledge mentioned above.

In such a case, none of the parties is served by requiring the information provider to collect the information anyway and to supply that information to the client, which costs both time and money. As the alleviation of the duty to inform is the exception to the rule, it is up to the information provider to prove the exception applies. The mere fact of the client's competence or the presence of another information provider is not sufficient reason to assume that the client was aware of the concrete information.

IV.C.–7:109: Causation

If the provider knows or could reasonably be expected to know that a subsequent decision will be based on the information to be provided, and if the client makes such a decision and suffers loss as a result, any non-performance of an obligation under the contract by the provider is presumed to have caused the loss if the client proves that, if the provider had provided all information required, it would have been reasonable for the client to have seriously considered making an alternative decision.

COMMENTS

A. General idea

The existence of a causal link between a non-performance of a contractual obligation by the provider and damage to the client is an essential element of the liability of the information provider and the availability of the remedy of damages. The determination of a causal link involves specific issues with regard to contracts for the provision of information. It is often difficult for the client to substantiate the existence of a causal link between the non-performance of the information provider's obligations and the damage suffered. In order to enable the client to substantiate a causal link, this Article introduces a modification of the burden of proof. The client can establish the existence of a causal link by proving that, if there had been proper performance, it would have been reasonable for the client to have seriously considered making a decision other than the one actually taken.

The phrase 'alternative decision' is to be interpreted broadly. It includes not only a completely different decision, but also the hypothesis of a decision having the same nature, though different conditions.

Illustration 1

A client acquires company A on the basis of wrong advice of a market analyst. In order to claim damages, the client does not have to prove that he would not have taken the decision he took nor that he would have taken the same decision though on different financial terms. The existence of a causal link between the wrong advice and the damage is presumed by the proof that a reasonable investor would

have seriously considered either not investing in or acquiring another company or acquiring company A at a lower price.

This Article introduces two presumptions. The first operates a modification of the object of proof. The client is not required to prove causation on the basis of the particular client test – i.e. what the client *would* have done – but on the basis of a reasonableness test – i.e. what it would have been reasonable to have done if correctly informed. The second alleviates the object of proof. The client is not required to prove that a reasonable client would have taken a different decision; it is sufficient that a reasonable client would have seriously considered taking another decision.

The information provider can rebut the two presumptions in the same way. In order to establish the absence of the causal link, the information provider needs to show that, even if there had been due performance, the client would have taken the same decision.

B. Interests at stake and policy considerations

The requirement of causation is frequently a key issue in claims for damages for non-performance of obligations under an information contract. The main issue is to determine whether the basic principles of causation are still to be applied or whether it is necessary to alleviate the requirement in favour of the client.

The argument in favour of alleviation of the usual burden of proof allocation with regard to causation can be explained as follows. The client requested information or advice to make a sound decision. It is therefore likely that the client will base a decision on the information supplied and will follow the advice given. For the same reason, it may be assumed that the client would have relied on correct information or followed correct advice or at least would have hesitated to take the decision actually taken on the incorrect recommendation of the provider. The result of this reasoning is that, in such a case, the information provider has to prove it would not have mattered if the information or the advice had been correct because the client's decision would have been the same as the one taken. If the provider cannot prove that, the causal link between the non-performance and the damage the client suffered is taken as established.

More practically, leaving the burden of proof of the existence of a causal link on the client would lead to a very difficult situation for the client. It would be necessary to prove that, if the provider had fulfilled the obligation correctly, the damage would not have occurred, which is usually impossible.

However, reversing or considerably alleviating the burden of proof on the client will place the information provider in an unfavourable position. It will be very difficult indeed to prove that the client, properly informed or advised, would have taken the same course of action. Thus, according to the solution chosen each party will face difficulties in establishing evidence.

Finally, the solution depends on a policy decision with regard to compensation for the client. The fact that professional information providers are often insured – which is sometimes a mandatory requirement – might justify alleviation of the causation requirement to allow speedy compensation of the damage suffered by the client, who is generally not insured against the consequences of such a breach.

C. Comparative overview

Alleviation of some sort of the burden of proof concerning a causal link between the non-performance by the information provider and the damage suffered by the client can be found in several Legal systems. The techniques used to achieve this result, however, differ. In Germany and Austria, especially with regard to medical information and advice, there is a partial modification of the object of proof in the application of the *Entscheidungskonflikt* ('conflict of decision') theory. In France, Belgium and Spain, courts turn to an unorthodox application of the loss-of-a-chance theory. In other words, courts consider that the client has lost the chance to take a decision on the basis of all the information needed.

D. Preferred option

The Article provides an alleviation of the client's burden of proof with regard to causation. The client does not have to prove that a different decision would have been taken if correct advice had been given, but merely that in such a case the client would have seriously considered taking another decision, thus avoiding the damage. Such a solution is very similar to the German *Entscheidungskonflikt* theory.

This Article applies an objective standard-client test, not the particular-client test. The existence of causation is assessed objectively, with particular regard to the situation of a reasonable client, not the one of the client in question. Following the standard-client test further facilitates the assessment of a causal link between the breach of duty and the damage.

Illustration 2

A company engages a firm of auditors to give advice in connection with a takeover. The auditors advise the client in favour of the takeover not noticing and therefore not mentioning in their advice the considerable risk that antitrust authorities would refuse to approve the acquisition due to the future monopolistic nature of the company. After the acquisition, it turns out that the European Commission is willing to approve the acquisition on the condition that the buyer resells 60 per cent of the assets of the target company. In order to receive compensation for the damage suffered, the client only has to prove that, if correctly informed of the risk that materialised, the company would have hesitated to go ahead with the takeover. It is then up to the adviser to prove that the client would have acquired the target company even if correctly informed.

By introducing a presumption with regard to the proof on causation, the Article implicitly excludes the application of the theory of the loss of a chance, applied in some legal

systems to facilitate the assessment of the causal link in the case of breach of an information duty and, therefore, compensation for the damage suffered. In applying the loss-of-a-chance theory as a surrogate for the proof of causation, courts compensate for the fact that the client lost the chance to take a decision on the basis of all the information needed. The consequence of this is that the client cannot be awarded compensation corresponding with the entire damage suffered. Damages correspond only to a percentage of the entire damage suffered. The percentage is determined according to the existence of chances to take a different decision and avoid the detrimental consequences of the decision actually taken. In practice, this leads to complex assessments of damages, which often require the appointment of experts.

The system of the present Article leads to full compensation for the damage suffered or to no compensation at all. Partial compensation – as following the loss-of-a-chance theory – is avoided. In other words, this Article is based on the consideration that non-performance by the provider is either the cause of the entire damage or not the cause of the damage.

CHAPTER 8: TREATMENT

IV.C.–8:101: Scope

(1) This Chapter applies to contracts under which one party, the treatment provider, undertakes to provide medical treatment for another party, the patient.

(2) It applies with appropriate adaptations to contracts under which the treatment provider undertakes to provide any other service in order to change the physical or mental condition of a person.

(3) Where the patient is not the contracting party, the patient is regarded as a third party on whom the contract confers rights corresponding to the obligations of the treatment provider imposed by this Chapter.

COMMENTS

A. General idea

This Article presents the notion of a treatment contract. The treatment activity consists in all the processes applied to a person in order to change his or her physical or mental health. The main example of a treatment contract is one for medical treatment. However, that is not the only example. Accordingly Annex 1 defines a contract for treatment as “a contract under which one party, the treatment provider, undertakes to provide medical treatment for another party, the patient, or to provide any other service in order to change the physical or mental condition of a person”.

Illustration 1

A patient suffering from the flu goes to a doctor. The doctor takes the various steps in the treatment procedure and prescribes drugs that may cure the illness, i.e. change the physical condition of the patient.

There will usually be “treatment” whenever a health-care professional takes the necessary steps to effectively change or maintain the condition of a patient or – where this is not or no longer possible – to mitigate the effects of chronic or incurable ailments.

Illustration 2

A patient who has incurable, terminal cancer is given palliative care. This treatment mitigates the pain suffered by the patient and comes within the scope of the Article.

Treatment may consist in making efforts to cure a certain ailment, in taking steps to prevent ailments from materialising in the future (preventive medicine) or in administering painkillers in the case of a deadly disease. It may also consist in changing the physical or mental condition of a person where there is no need from a strictly medical point of view to do so (aesthetic surgery, sterilisation, etc.).

Illustration 3

A person who is planning to travel to an area where malaria is prevalent has an appointment with a health-care provider well before his departure. He is given appropriate medication. This situation concerns preventive medicine, and this Chapter applies.

The present Chapter also applies, with appropriate modifications, in situations where the treatment provider performs another service in order to change the physical or mental condition of the patient, such as providing information regarding treatment, referring to another health-care provider or institution, etc. (paragraph (2)).

Paragraph (3) states that the provisions of this Chapter also apply to contracts concluded by a third party on behalf of a patient and that that patient has the right to demand performance by the treatment provider. Although usually the patient is the contractual party, it may happen that the patient is *not* the contractual party. This is, for instance, the case when a treatment provider is employed by a party who has some legal connection with the patient, such as treatment providers employed by the patient’s employer or by an insurance company.

Illustration 4

A woman applying for a life insurance policy gets a check up in a clinic contracted by the insurer. The woman is contractually protected vis-à-vis the clinic under this Chapter.

Paragraph (4) extends the application of these rules, by way of analogy, to some borderline situations where the provider of another service provides treatment to a person.

Illustration 5

A person goes to the hairdresser's to have his hair cut. This is a process that changes a person's physical (aesthetic) condition (though not his health). Although this Chapter does not cover such a situation, the provisions may apply by way of analogy.

Illustration 6

The hairdresser notices that the client has a severe case of dandruff (diagnosis) and recommends a special shampoo (therapy) to cure it. Although this Chapter does not cover such a situation, the provisions may apply by way of analogy.

B. Interests at stake and policy considerations

This Article covers the scope of application of the rules in this Chapter. The most common application will be that of a patient entering into a contract with a treatment provider in order to receive treatment. However, an important policy issue is whether the Chapter should apply to situations where a clear contractual link is lacking. On the one hand, it may be argued that for conceptual reasons only treatment provided after a treatment provider and a patient concluded a contract should fall within the scope of this Article. On the other hand, not broadening the scope of these rules to the aforementioned situations would amount to discrimination, not treating identical situations alike, without any practical reason. In fact, it often happens that the patient and the person or entity concluding the treatment contract are not the same. This is the case when treatment is provided to minors lacking contractual capacity or incompetent adults. It is also the case when an employer, an insurance company, a hotel or a similar organisation enters into a contract with a treatment provider in order to provide treatment for employees, insured persons and hotel guests. In such a situation, there are two levels: the 'client'-treatment provider relationship and the patient-treatment provider relationship.

Illustration 7

A passenger of a cruise ship feels ill during the cruise. The ship's doctor, employed by the company, treats the passenger. In this situation, the passenger/patient was treated by a doctor whose contractual relationship is with the company, not with the patient. The present Chapter applies nevertheless.

Another question to be answered is whether there can be a contractual relationship between a patient and a public hospital. Such a contractual relationship would contribute to a unified legal regime of the obligation to treat, bringing out the advantages of clarity, certainty and protection of the patient as a consumer. However, from a political and

economic point of view, such an option would meet with heavy resistance in many countries, as many hospitals are public hospitals, and as such ruled by administrative law.

Besides, some conceptual arguments tend to classify relationships between hospitals and patients as different from contracts, rather as ‘mass factual relationships’. The law on non-contractual liability for damage or administrative law deals with liability as regards the liability of public entities.

Another policy issue concerns the scope of the rules on treatment, especially with regard to borderline situations. In fact, improving the physical or mental health of a person is a broad definition of the activity, likely to cover treatment activities such as grooming, hairdressing and body piercing as well. Apart from fitting the normal scope of treatment, broadening the scope of this Chapter to such activities would result in an increase in the quality of those services as well as in the extended protection of the client of such services. This may especially be relevant in situations where performance of such services may have similar consequences for the health of the patient as medical treatment. On the other hand, restricting the scope of the Chapter entails that treatment can be narrowed down to standard medical practice. This would be more in line with what traditionally is regarded as treatment, and has the advantage of focusing on the main issue, medical treatment, or at least the issue that has the greatest impact on society and the economy. Besides, incorporating the aforementioned services would result in fierce resistance from the medical community.

C. Comparative overview

In most European countries, the contract for treatment falls into the existing categories of contracts for services (Germany, Spain, and Portugal), or contracts for work (France). In some legal systems it is not clear if treatment is qualified as a contract for work or services or if it is a specific innominate *sui generis* contract (Austria and Greece). The only country regulating the contract for treatment as a nominate contract in the CC is The Netherlands.

In the United Kingdom, the relationship between a patient and a public hospital is regarded as non-contractual, rather disciplined by the law on non-contractual liability for damage. In Finland and Sweden the relationship is not contractual and specific regulation for medical healthcare, in particular the no-fault patient insurance scheme applies.

D. Preferred option

In principle, the Chapter applies only in so far as there is a contractual relationship between a treatment provider and the patient. However, if under national law the relationship cannot be qualified as a private law contract, the present Chapter does not apply; administrative courts may, irrespective of its private law nature and of their own accord, apply the rules of this Chapter by analogy.

The scope of application is extended to treatment provided on behalf of a person who is not a contractual party; see paragraph (3). The underlying reason is the protection of patients and treating like situations alike. In exceptional circumstances, where treatment must be performed immediately to serve the best interests of the patient and the patient cannot express agreement to the contract the rules on benevolent intervention in another's affairs may apply.

In situations where a service is provided in order to change the physical or mental health of a person outside the scope of medical treatment, this Chapter applies with appropriate adaptations; see paragraph (2); The underlying reasoning relates to the functional character of the rules and to the provision of normative guidelines for adjudicating legal problems emerging from the sector of unconventional medicine, which is becoming more and more important from an economic point of view. Likewise, this Article serves the objectives of patient protection and public interest in the quality of health care.

IV.C.–8:102: Preliminary assessment

The treatment provider must, in so far as this may reasonably be considered necessary for the performance of the service:

- (a) interview the patient about the patient's health condition, symptoms, previous illnesses, allergies, previous or other current treatment and the patient's preferences and priorities in relation to the treatment;*
- (b) carry out the examinations necessary to diagnose the health condition of the patient; and*
- (c) consult with any other treatment providers involved in the treatment of the patient.*

COMMENTS

A. General idea

This Article states the steps the treatment provider is to take in order to assess the condition of the patient and to determine adequately the phases of treatment. In order to be able to meet the core obligation to treat, the treatment provider is required to investigate the health status of the patient. This will typically consist of *anamnesis* (information received from the patient), requiring the co-operation of the patient, and of *diagnosis*, i.e. the interpretation of the symptoms of the patient, possibly involving analyses or examinations that the patient has undergone.

During diagnosis, the symptoms and the data gathered by the treatment provider will be interpreted according to his or her technical knowledge and experience, and the result will be the identification of the cause of the ailment. This is the first step in the treatment provider's obligation to treat. After having received the information, the treatment provider needs to diagnose the ailment.

B. Interests at stake and policy considerations

A correct diagnosis is crucial for the success of treatment. A diagnosis which is based on the assessment of the existing health situation, i.e. a probability judgement of the condition of the patient, will provide the basis for the development of an adequate treatment strategy. The diagnosis itself is based on data gathered, followed by an analysis of that data. Medicine can never be 100 per cent exact, and a diagnosis is but a judgement based on scientific probability. Assessment of the existing physical condition of a patient and the subsequent diagnosis must thus conform to the standard of care of the average competent treatment provider.

It is debated, however, whether an incorrect diagnosis can be a ground for liability. It is widely held that an incorrect diagnosis does not constitute a breach of the standard of care, as it would be an error of judgement due to the existence of several possible causes of the ailment. It is often argued that only a blunt mistake in appreciating simple medical data and in interpreting that data, constitutes a breach of the standard of care.

Another issue is how far-reaching this obligation should be. A thorough diagnosis demands time and resources. Overdiagnosis will be lengthy, expensive, unnecessary and risky. Many diagnostic techniques, in particular invasive diagnostic procedures, present risks. They may also be a waste of limited health-care resources.

Illustration 1

During the process of diagnosis, physicians conclude that the patient most probably suffers from tuberculosis. There is, however, a very slight chance that he suffers from Hodgkin's disease, a malignancy of lymph tissue. The physicians decide that the patient should undergo an invasive diagnostic technique, mediastinoscopy, which presents the risk of injury to the vocal cords. The risk materialises in this case. The patient, apart from arguing the fact that he did not consent to the examination, argues that the diagnostic examination was disproportionate to the condition he was in.

On the other hand, incomplete diagnosis will very often contribute to a defective performance of treatment, as not enough data was available in order to enable a standard quality treatment.

C. Preferred option

A reasonableness test is the preferred criterion for assessing how thoroughly the treatment provider must execute the diagnosis. This is in line with the provision in IV.C.–8:104 (Obligation of skill and care). The treatment provider must, in so far as this may reasonably be considered necessary, interview the patient, carry out examinations and consult with other treatment providers in order to assess the underlying health status of the patient. Arguments excluding or limiting the establishment of liability for a defective diagnosis do not seem to be persuasive. Liability exists in so far as the treatment provider

failed to carry out the examinations reasonably considered necessary, or the diagnosis judgement was sub-standard.

This reasonability test seems the most adequate approach to how thorough the diagnosis should be and consists in balancing the following factors: (a) standards and guidelines of approved, sound medical practice; (b) economic efficiency in healthcare resources allocation and (c) risk–benefit analysis.

Under this Article, the treatment provider, in so far as may reasonably be considered necessary, is to consult with other treatment providers involved in the treatment or previous treatment of the patient, in order to obtain important information on clinical history, allergies, medication, other treatment the patient is receiving, etc., so as to acquire more data relevant to the diagnosis.

IV.C.–8:103: Obligations regarding instruments, medicines, materials, installations and premises

(1) The treatment provider must use instruments, medicines, materials, installations and premises which are of at least the quality demanded by accepted and sound professional practice, which conform to applicable statutory rules, and which are fit to achieve the particular purpose for which they are to be used.

(2) The parties may not, to the detriment of the patient, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

This Article addresses the obligations of the treatment provider regarding the instruments, medicines, materials, installations and premises used for the treatment. One of the characteristics of contemporary medical practice is technological evolution. Medical science and practice are more and more dependent on sophisticated technological devices, presenting specific risks. Although the efficiency of treatment has significantly improved, the chance of an unpredictable adverse event remains and in some respects may even have increased (cf. *G. Viney, (ed.), L'indemnisation des accidents médicaux*, L.G.D.J., Paris, 1997, p. 108).

The medical products used, including devices, instruments and drugs, must conform to approved professional standards and should be adequately inspected, monitored and maintained. Treatment providers must avoid using obsolete or malfunctioning devices, materials and installations.

B. Interests at stake and policy considerations

The materials, instruments, devices, installations and products used during treatment are essential for the performance of the treatment contract. They must be of at least standard quality, and must be adequately maintained and operated in order to insure the safety of patients. This input brings, especially in modern high-technology based medicine, an increase in the potential benefits of treatment, but sometimes also an increase in the risks because of the complexity or inherent hazardousness of such input.

Defective input is, according to statistical data, a common cause of failure to perform properly the obligation to treat. Quite often in hospital settings, such defective input is a latent source of potential errors.

Illustration 1

A patient undergoes an X-ray examination. Radiation exposure should be between 50 and 200 millirem, but due to a defect in the X-ray machine, the patient was exposed to 1 rem, a very high and potentially harmful dose of radiation. In this case, a medical device malfunctioned, and the patient may have sustained injury resulting from the examination.

The installations where treatment is carried out can also contribute towards non-performance: a good example is ‘nosocomial’ infections, infections endemic in hospital premises. Some of these pathogenic agents are drug resistant. Patients who are subject to invasive diagnosis or treatment as well as prolonged hospitalisation are often prone to contract such infections. Measures can be taken in order to reduce the impact of nosocomial diseases in a hospital, but they can never be eliminated: minimising time between admission and surgical procedures, choosing appropriate surgical prophylaxis, isolation facilities, screening procedures, effective hospital cleaning and disinfection. In Britain, approximately 15 per cent of all patients admitted to hospitals contract hospital-related infections. In France, the probability of contracting a serious infection after complex surgery is 33 per cent; in Denmark, however, only 2 per cent.

Illustration 2

A patient who underwent heart surgery contracts a nosocomial, drug-resistant infection in spite of all the aseptic measures taken. The patient sustains an illness as a consequence of the defective nature of the installations used for the performance of the treatment.

The main policy question in relation to this Article is the intensity of the duty of care of the treatment provider while employing this sort of input. On the one hand, it can be argued that the treatment provider should be liable only if there is a breach of the duty of care while employing this kind of input, i.e. not operating, servicing or maintaining the input in conformity with applicable regulations, equipment instructions or approved practise, or not meeting the required standard of care. This is the traditional view on

medical malpractice, which stresses the importance of the deterrent effect of fault-based liability.

On the other hand, it is sometimes held that the treatment provider should be strictly liable, as there should be an obligation to ensure the safety of the patient. According to this position, the treatment provider has an obligation of result regarding the safety of the patient, meaning that it must shield the patient from harm from defective or insufficient choice, servicing, maintenance, operation or design of medical equipment, devices and installations.

A middle position establishes a presumption of fault on the part of the treatment provider, allowing the provider to prove that it has acted according to the required standard of care and applicable regulations or approved medical practice in order to avoid harm to the patient.

C. Comparative overview

The duty of the treatment provider concerning the use of adequate input such as instruments, medicines and materials exists in all analysed legal systems, though the consequences of the breach of this duty varies. In The Netherlands and Portugal the treatment provider is held liable in so far as it breached the standard of care while using or administering this input. The same is true in France, Germany and Spain, though the burden of proof of breach of this duty may shift to the treatment provider. In Denmark, Finland and Sweden, liability is strict.

The duty of the treatment provider to use adequate installations is also recognised in all countries, and is of particular importance in the case of hospital-acquired infections. However, in Germany, France and Spain the burden of proof of breach of the duty may shift to the treatment provider. In Denmark, Finland and Sweden injury caused by preventable infections is compensated.

D. Preferred option

The preferred option is a strict liability of the treatment provider regarding the materials, instruments, devices, products and installations used in performing the treatment obligations. This input must be fit for its purpose.

Given the complexity of, and inherent risk associated with, much of that input a strict liability seems appropriate. The complexity of such devices and the possibility of a technical or human malfunction while operating them render such a strong liability a necessity. There is also a significant risk of an unexpected random failure of the equipment, especially if it is very sophisticated or complex.

This approach is in the interests of patients as it makes it easier to obtain compensation for treatment injury: it is not necessary to establish fault on the part of the treatment provider. To some extent, it is also in the interests of healthcare professionals as there is

no need to establish that a particular professional is to be ‘blamed’ for the occurrence of the injury. The presence of defective equipment in a treatment providing institution is regarded as something which can be adequately controlled and prevented only at the level of the system or institution. This is a shift from personal to collective or organisational liability.

Moreover, empirical studies suggest that the deterrent effect of fault-based liability at the individual level in relation to defective input is ineffective. Studies point out that integrated proactive measures (surveillance and checking of material, equipment, devices and products) are more suitable to prevent such medical accidents.

In the aftermath of several tragedies related to defective input in treatment (HIV and Hepatitis B/C contaminated blood; Thalidomide-related handicaps, etc.) as well as the high statistical incidence and impact of the materialisation of some input risks (e.g. in France more people are affected by nosocomial infections than by car accidents), public opinion became very sensitive regarding the issue. Understandably, policy-makers are very keen on this approach as it is a more adequate way of achieving efficient compensation for such injuries and preventing mass litigation and the difficult financial consequences that can emerge from it.

With regard to paragraph (2) it should be noted that the prohibition on contracting out does not exclude derogations to the benefit of the patient. This could be particularly important in an emergency where the choice may be between using inadequate instruments and materials or allowing the patient to die or suffer irreparable harm. In such a case, of course, the patient could consent to the use of the best instruments or materials available.

IV.C.–8:104: Obligation of skill and care

(1) The treatment provider’s obligation of skill and care requires in particular the treatment provider to provide the patient with the care and skill which a reasonable treatment provider exercising and professing care and skill would demonstrate under the given circumstances.

(2) If the treatment provider lacks the experience or skill to treat the patient with the required degree of skill and care, the treatment provider must refer the patient to a treatment provider who can.

(3) The parties may not, to the detriment of the patient, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The treatment provider has, as a service provider, an obligation of skill and care under IV.C.–2:105 (Obligation of skill and care). This Article provides some further guidance. It uses the objective standard of a reasonable treatment provider exercising and professing care and skill.

The objective standard can be modulated by specific subjective or concrete factors, such as the specialisation of the treatment provider, the circumstances or the agreement of the parties. Thus, the criterion for assessment of the standard required is that of the reasonably competent professional, acting in conformity with the guidelines, Directives and protocols set by the current state of the medical science, under the concrete circumstances in which treatment must be performed (*lex artis ad hoc*).

Illustration 1

A patient has broken her leg when she fell during a hike. She is treated at a hospital. The doctor, a general practitioner attached to the hospital, is to treat the patient with the skill and care of a reasonable general practitioner. He treats the patient, after having judged the data from an X-ray examination, by putting on a splint.

Illustration 2

The same doctor is called later at night to accompany ambulance personnel and to help the victim of a car crash on the spot. No X-ray device is available. In this case, the circumstances (time, place, lack of means) significantly decrease the demands as regards the skill and care required from the doctor.

Specialised medical skills and experience will raise the standard of care required from the health-care professional. The more specialised or experienced a health-care professional is, the greater the skill which can be expected to be demonstrated. Inexperience is no defence, as even a starting health-care professional is expected to have at least average skill and competence.

Illustration 3

A patient, whose particular type of skin rash was wrongly diagnosed by a general practitioner, receives inadequate treatment. After some time, she decides to consult a dermatologist, who diagnoses a rare skin disease and prescribes adequate therapy. This specific knowledge of skin diseases may not be expected from a general practitioner, but it would be expected from a dermatologist.

The treatment provider must meet the standard of the average reasonable health-care professional. Whenever a treatment provider acknowledges that he or she is not skilled enough, or does not have the specialised skill fit for the treatment of the concrete ailment

of the patient, there is an obligation to refer the patient to a specialist in that field, or alternatively, to consult with such a professional.

An “unconventional” or “alternative” health professional (e.g. an acupuncturist) has to live up to the normal standard of care expected in that field and what may reasonably be expected of the treatment provider given the normal care that the patient may expect and what care could have been expected in regular medicine.

B. Interests at stake and policy considerations

This is a key provision in establishing liability for non-performance of the treatment provider’s obligations. There are two contrasting approaches to this problem in Europe. The traditional negligence approach holds the treatment provider liable only in so far as it did not duly perform the obligation of skill and care. According to the second approach, the compensation of the patient does not depend on any such non-performance, and compensation is provided or backed up by a special compensation scheme.

In the case of negligence, several interests are at stake in defining and interpreting the standard of care. A very stringent standard of care will trigger lower activity levels, as the treatment provider will perform treatment more thoroughly, as well as the engagement of treatment providers in defensive medicine, avoiding the use of any risky techniques, even if, after a cost–benefit balance these seem to be more in the interests of the patient. Another economic consequence is the inflation of insurance premiums, the cost of which will eventually spread to the final costs of health care. On the other hand, a less stringent standard of care would make it more difficult for a patient to obtain compensation, a fact that could result in unfairness, professional impunity and costly consequences for the patient or the welfare system. Besides, the overall quality of health care might potentially decrease, unless other accountability mechanisms (disciplinary or penal) are reinforced.

Another important discussion relates to the modulation of the standard of care when inexperienced health professionals are concerned. It is traditionally held that the standard of care is an objective threshold that cannot be lowered. If a healthcare professional cannot comply with the minimum standard of care due to inexperience, the patient should be referred to an experienced health professional. On the other hand, it is held that, in the field of medicine, experience only comes with practice, and as the training of health-care professionals benefits society at large, society should internalise the risks inherent to their training.

Extending liability beyond fault, in situations where treatment accidents are concerned, presents many problems of both a legal and economic character that only with difficulty can be solved in the field of traditional liability law. A system can be developed in which such treatment accidents can be compensated, shifting the treatment risks away from the patient or welfare system. However, it would not be reasonable or fair to impose them on the treatment providers. Though comparative research shows that several countries have successfully implemented compensation of treatment accidents independent of any

breach of a duty of care, these compensation schemes are implemented either through insurance law or through administrative law, sometimes replacing liability law for most practical purposes.

C. Comparative overview

In Austria, England, France, Germany, Greece, Italy, The Netherlands, Spain, Portugal the treatment provider owes the patient the care and skill of a reasonable treatment provider of average competence. This is an objective standard of care. In Denmark, Finland and Sweden, where no-fault patient insurance schemes operate, the standard of care is more stringent: patients will obtain compensation if the injury sustained could have been prevented had the patient been treated by a specialist treatment provider.

It is unanimously held that the standard of care is not lowered below the general standard if the treatment provider is inexperienced. If the treatment provider is a specialist, the standard of care is raised in Austria, England, Germany, The Netherlands, Spain and Portugal, but not in France and Italy. In Denmark, Finland and Sweden the general standard of care is already that of a specialist treatment provider.

In medical experimentation, the standard of care does not change in France, Germany, Italy, The Netherlands, Spain and Sweden. The standard of care is, in practice, more stringent in Austria, England and Greece, and strict liability exists in Portugal. In the case of unconventional treatment, the treatment provider appears to be bound by the general standard of care.

The patient bears the burden of proof of the breach of this duty in Austria, England, France, Germany, Greece, Italy, The Netherlands, Portugal and Spain. In Italy, Germany, Greece, The Netherlands, Portugal and Spain the burden of proof can be alleviated or shifted to the treatment provider in exceptional circumstances. In Denmark, Finland and Sweden, due to the non-adversarial nature of the no-fault patient insurance schemes, the circumstances concerning the injury sustained by the patient are investigated *ex officio* by the patient insurance consortium.

D. Preferred option

This Article establishes, as a general principle, a fault-based liability system for treatment contracts, apart from the obligations under IV.C.–8:103 (Obligation regarding instruments, medicines, materials, installations and premises). The main reason is that a non-fault system demands complex political decision-making and a financial mechanism to back it. A system compensating treatment accidents regardless of fault, where the costs of accidents could be spread and reduced, can only reasonably be addressed by specific insurance or social solidarity fund schemes, beyond the scope of liability law.

This does not preclude the implementation of voluntary or statutory insurance or social schemes in order to compensate some treatment accidents on a strict liability or no-fault

basis. Additionally, specific statutes or regulations of the national healthcare systems may impose a different approach beyond this general principle.

Fault thus consists in non-conformity with the required standard of care. The standard of care set by this provision is a carefully balanced objective or abstract standard, though it can be modulated by some subjective or concrete factors, such as experience, circumstances and magnitude of the risks involved.

The standard of care required from an experienced health-care professional should not be below that required from an average competent health-care professional. This introduces more certainty and a higher level of patient protection. It should be noticed, however, that, although inexperienced health-care professionals are not exempted from the general standard of care, society as a whole benefits from their training, and so society and the healthcare system should internalise the consequences of mishaps caused by those inexperienced healthcare professionals. This is reflected in some other provisions in this Chapter which provide to some extent for collective and organisational liability instead of personal liability. See IV.C.–8:103 (Obligations regarding instruments, medicines, materials, installations and premises) and IV.C.–8:111 (Obligations of treatment-providing organisations). Likewise, paragraph (2) of this Article recognises the problem of inexperienced practitioners by providing for the patient to be referred to a treatment provider having the necessary experience or specialised skill.

IV.C.–8:105: Obligation to inform

(1) The treatment provider must, in order to give the patient a free choice regarding treatment, inform the patient about, in particular:

- (a) the patient's existing state of health;*
- (b) the nature of the proposed treatment;*
- (c) the advantages of the proposed treatment;*
- (d) the risks of the proposed treatment;*
- (e) the alternatives to the proposed treatment, and their advantages and risks as compared to those of the proposed treatment; and*
- (f) the consequences of not having treatment.*

(2) The treatment provider must, in any case, inform the patient about any risk or alternative which might reasonably influence the patient's decision on whether to give consent to the proposed treatment or not. It is presumed that a risk might reasonably influence that decision if its materialisation would lead to serious detriment to the patient. Unless otherwise provided, the obligation to inform is subject to the provisions of Chapter 7 (Information and Advice).

(3) The information must be provided in a way understandable to the patient.

COMMENTS

A. General idea

This Article deals with the treatment provider's obligation to inform the patient or whoever takes decisions on the patient's behalf. Information is to be disclosed in order to allow the patient an informed choice regarding treatment and obtain informed consent.

With regard to the patient's autonomy, the treatment provider is under an obligation to disclose, in a clear and understandable way, all the information regarding the patient's health status and his or her illness as well as the proposed treatment. The information about the proposed treatment that must be disclosed to the patient consists of several elements. The patient must be informed of the risks of the proposed treatment, about alternative treatment techniques as well as the risks of them and, finally, the prognosis of the patient's health if the patient decides to agree to the proposed treatment, to do without it or to do without any treatment. In particular, the consequences of not having treatment, as well as the potential benefits to be expected from treatment must be made very clear to the patient. Thus, the patient will be in a position to make an informed choice as regards the treatment strategy.

Illustration 1

A patient considers undergoing laser eye surgery in order to correct myopia. The ophthalmologist informs her of the risks and potential benefits of having surgery performed, in particular the (low but existent) risks of blindness, as well as those of refraining from surgery (myopia will gradually advance, lenses will be thicker, risk of eventual total loss of sight). He informs the patient of alternative treatment, like traditional eye surgery, but points out that the risks are higher and the post-surgery period more difficult. The patient is now in a position to make an informed choice on whether or not to undergo surgery.

B. Interests at stake and policy considerations

The patient has a right to be informed, to make an informed choice in regard to treatment, and to consent in regard to his or her bodily security and right to self-determination. The treatment provider has an obligation to inform, but how thorough must the information be? A very thorough obligation to inform is costly, as its performance takes more time, fewer patients can be treated and expenses rebound against the patient or the healthcare system.

It can be argued that all risks must be disclosed, however slight the chance of their materialisation. However, it might be excessive to require the treatment provider to inform the patient of very unlikely possibilities. In any treatment, there exist known risks the materialisation of which is rare. Disclosing them to the patient might deter the patient from undergoing a treatment which would be beneficial. Too much information that the patient cannot reasonably process may lead to situations where the patient cannot make an informed choice or makes an unreasonable decision.

Illustration 2

The medical literature mentions only one case where the use of a certain drug in combination with another specific drug resulted in toxic delirium. As this is a very rare adverse reaction, there is no need to inform the patient of it.

Another relevant factor is urgency. The more urgent the treatment is, the less information needs to be provided. When a patient needs immediate treatment, information will be scarce in the pre-treatment phase; when immediate treatment is not required, the extent of the information to be disclosed will be greater. Another criterion, the necessity criterion, requires that the obligation to inform will be more stringent when (from a purely medical point of view) treatment is less necessary.

Another debate concerns the scope of the alternatives to be mentioned, in particular as to the mentioning of unconventional treatment alternatives. Unconventional treatment (such as acupuncture, homeopathy, osteopathy, Chinese traditional medicine, etc.) is becoming more and more popular, presenting in some circumstances effective alternatives that conventional medicine cannot offer. The question is whether the traditional health-care provider is under a duty to inform the patient about unconventional treatment alternatives. It may be argued that the duty to inform only applies to alternatives offered by the same scientific field, and that an MD cannot be expected to know the therapies existent in other treatment techniques. On the other hand, as a healthcare professional is not he or she expected to have a broad knowledge of all sound treatment techniques? Then again, what constitutes a *sound* treatment technique if it is not accepted in medical practice?

A related issue concerns the form in which information is to be provided. It is common hospital practice to provide a patient with a form containing general information, in correct medical jargon, and space for the patient's signature, who thus gives consent. However, should the information not be tailored to the specific patient and be conveyed personally by the treatment provider in a way which the patient can understand?

Illustration 3

A virtuoso opera singer is informed that a certain treatment entails a 0,1 per cent possibility that the vocal cords will be slightly injured, thus causing the loss of the ability to sing in the correct pitch in some octaves. A manual worker needing the same treatment is not informed of that risk. If provided with a form explaining the most significant risks of the treatment, stated in medical jargon, the patient would probably not understand exactly the stakes involved. Also, such standardized information would not point out a risk that would not be relevant to a normal patient, but whose materialisation would be detrimental to this opera singer.

C. Preferred option

The preferred option is to provide that only risks which may reasonably influence the patient's decision on treatment must be disclosed. It is presumed that such risks will

influence the patient's decision if their materialisation would lead to serious detriment to the patient (death, disfigurement, permanent disability). This presumption does not exclude other criteria for the determination of the relevant information to be disclosed, such as the rate of the risk's materialisation, subject to standard rules regarding the burden of proof. Thus, the obligation to inform consists in telling the patient what he or she reasonably needs to know in order to make an informed choice. Also, the less urgent treatment is, the more detailed the information must be, as some time can be allocated for the exploration of alternatives and weighing the risks and benefits.

The patient's interests regarding autonomy are safeguarded, as well as the hospital's and the professional's interests regarding organisation of time. This also reduces the risk that a patient is deterred from undergoing treatment owing to information overload.

Serious and sound relevant alternatives, even if offered by unconventional medicine, are to be disclosed to the patient in so far as the standard of care so requires. This approach gives patients the possibility of choosing between different alternatives available.

The treatment provider is to present the information in a personalised, direct way. The information should be adapted to the situation of that specific patient and expressed in a way which is understandable by the patient. If information is provided through a form stated in medical jargon, however thorough the content of the information may be, an average patient will not be able to understand it. On the other hand, if tailor-made information is disclosed personally, by a health-care professional, in a briefing session and in language understandable to the patient, then that patient will be adequately informed. The treatment provider must make a reasonable effort to help the patient understand the information. This is the best way of respecting the patient's autonomy.

IV.C.–8:106: Obligation to inform in case of unnecessary or experimental treatment

(1) If the treatment is not necessary for the preservation or improvement of the patient's health, the treatment provider must disclose all known risks.

(2) If the treatment is experimental, the treatment provider must disclose all information regarding the objectives of the experiment, the nature of the treatment, its advantages and risks and the alternatives, even if only potential.

(3) The parties may not, to the detriment of the patient, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

This Article describes the extent of the obligation to inform when experimental or unnecessary treatment is concerned. Experimental treatment consists in treatment which

is still in a research stage and may be of benefit to the patient, treatment which departs from approved practice and may be of benefit to the patient or treatment of a kind which has not been yet fully developed and does not meet the standard of approved medical practice. In this type of treatment, there are unexpected risks as the treatment technique is still in an experimental stage or its risks are not yet fully known.

Illustration 1

A patient suffering from an incurable illness is invited to participate in the clinical trial of a drug that has not yet been tested before on humans. This drug can potentially have a beneficial effect on the patient. This is a case of experimental treatment.

Illustration 2

A patient suffering from cancer is informed that there is a novel technique, not yet fully tested, that can potentially be life-saving. This is also a situation of experimental treatment.

Unnecessary treatment here means treatment which is not intended to improve the physical health of the patient; it is rather treatment which a patient can choose to have for other reasons. Examples might be plastic surgery, sterilisation or active organ donation. This does not mean, however, that such treatment may not have therapeutic effects from a medical point of view.

Illustration 3

A 23-year-old woman had a car accident, and as a result acquired severe burns on her cheeks. Two years after the accident, the woman consults a plastic surgeon to have the burns removed. This is a case of unnecessary treatment, in the sense that there is no reason, from a strictly medical point of view, for the woman to undergo surgery.

This illustration shows how difficult it is to define the term ‘unnecessary treatment’, as having the burns removed may have a positive effect on a person’s mental health, as the appearance of the burns may have caused loss of self-confidence as well as adverse social circumstances detrimental to the woman’s mental health.

B. Interests at stake and policy considerations

Patients are particularly in need of protection in experimental treatments. Thus, there is a need of a reinforced information regime. The argument here is that two cost-benefit analyses are to be made, not just one. The first concerns the personal risk-benefit assessment, i.e. the balance between the potential benefits to the patient’s health and the risks involved in the experimental treatment. The second is the ‘altruistic’ risk-benefit analysis, i.e. the balance between the benefits to medicine and other patients and the risks the patient will run. The patient undergoing experimental treatment has an interest in being informed about the nature of the experimental treatment, the relevance of the trial to medical science and the potential benefit, if any, to his or her health. It is also

important for the patient to be informed about the possibility of being placed in the control group if there is one, i.e. a group that will be administered a placebo instead of the drug being tried. The patient has also a manifest interest in being informed about any health risks in the experiment. On the other hand, it may be in the medical researcher's interest to disclose as little information as possible for research secrecy's sake.

Illustration 4

A patient suffering from an incurable illness is invited to participate in the clinical trial of a drug that has not been tested before on humans. The patient will be interested in being informed about the nature and objective of the experiment, the risks involved in the experimental treatment, the potential benefits to his health as well as to the advance of medicine, and the chances that he will be assigned to the control group, and thus will not be exposed to the risks nor enjoy the potential benefits of the trial. On the other hand, the researcher and the promoter of the experimental treatment will not want to disclose too much information on the technical and scientific aspects of the experimental treatment.

In relation to novel treatment techniques, the patient will be interested not only in the normal information as regards the proposed treatment, but also in information on alternatives and on the risks involved in such techniques. The patient needs information to enable him or her to ascertain whether the benefits of the novel treatment technique outweigh its risks compared to the risks and benefits of treatment techniques already accepted by medical practice.

It is often argued that, in unnecessary treatment, the duty to inform is more stringent as there is no urgency in its performance and it differs from the risk-benefit analysis in normal medical treatment where, if all risks are disclosed and regardless of the low probability of their materialisation, there is a possibility that the patient overestimates that risk *vis-à-vis* the potential benefits of the treatment needed. It is argued that if treatment is unnecessary from a strictly medical point of view, all risks should be disclosed as the patient has the option of foregoing treatment without significant detriment to his or her health. This is the necessity criterion, pushing for a specific, more stringent duty to inform. Likewise, according to the urgency criterion, the absence of any need for immediate treatment means that there is plenty of time for protracted decision making and engaging in a more thorough risk-benefit assessment.

C. Preferred option

Like the laws of all the countries analysed, the Article opts for requiring fuller disclosure in the case of experimental or unnecessary treatment. This Article adapts the intensity of the duty to inform of the preceding Article to circumstances where the treatment to be performed is experimental (including in this term novel techniques not yet fully tested) or is unnecessary from a strictly medical point of view. The rule in this Article is mandatory in favour of the patient (paragraph (3)).

IV.C.–8:107: Exceptions to the obligation to inform

(1) Information which would normally have to be provided by virtue of the obligation to inform may be withheld from the patient:

(a) if there are objective reasons to believe that it would seriously and negatively influence the patient's health or life; or

(b) if the patient expressly states a wish not to be informed, provided that the non-disclosure of the information does not endanger the health or safety of third parties.

(2) The obligation to inform need not be performed where treatment must be provided in an emergency. In such a case the treatment provider must, so far as possible, provide the information later.

COMMENTS

A. General idea

This Article covers the exceptions to the obligation to inform. The first exception, in paragraph (1)(a), is the so-called therapeutic exception. In some circumstances, disclosure to a patient may result in serious consequences for his or her life, health and treatment. For example, the truth may, given the patient's known disposition, cause a dangerous shock liable to provoke mental instability.

Illustration 1

A patient is suffering from a severe cardiac disease. She needs to undergo bypass surgery. The situation is very delicate, and any shock or strong emotion entails the risk of a fatal stroke. The treatment provider decides to withhold information from the patient about her health status and to perform surgery. This is a situation of therapeutic exception to the duty to inform.

It should be noted that the therapeutic exception will not, by its very nature, apply in the case of the information required to be disclosed under IV.C.–8:106 (Obligation to inform in the case of unnecessary or experimental treatment).

The second exception, in paragraph (1)(b), concerns the 'right not to know'. Respect for the patient's autonomy implies that the patient has the right to decline to be informed, unless disclosure is necessary in order to protect the health status of third parties or the public interest, as is often the case with genetic and infectious diseases.

Illustration 2

A patient is admitted to a hospital, suspected of having cancer. The patient states expressly that he does not want to be informed of anything; he just wants to be treated in whatever way the treatment provider finds most appropriate. The patient is entitled not to be informed.

Paragraph (2) of this Article provides for yet another exception. If, owing to an emergency or temporary mental impairment of the patient, it is impossible to inform him or her and if it is not possible to obtain informed consent from someone entitled to take decisions on the patient's behalf, treatment may be carried out. However, the treatment provider must inform the patient (as required by IV.C.–8:105 (Obligation to inform)) as soon as possible. Subsequent treatment depends on renewed information and consent.

B. Interests at stake and policy considerations

The therapeutic exception is a debated topic. According to the Hippocratic paradigm, the patient had but a passive role in treatment, being guided blindfolded as it were by the physician throughout treatment. No information whatsoever was provided, as it would only harm and confuse the patient. As health care became more easily accessible in developed countries and patients became better informed, this paradigm started to collapse in the twentieth century and the principle of patient autonomy developed.

It is often argued that no information should be withheld from the patient, as it enhances the patient's autonomy and self-determination. However, the role of the mind and suggestion in the success of treatment should not be underestimated; according to psychology, information can needlessly interfere with treatment or cause needless suffering. However, empirical studies suggest that treatment providers often abuse the vagueness of the therapeutic exception to shirk the duty to inform the patient. Other specialists argue that the therapeutic exception should only exist in so far as the life or health of the patient is at risk, and even then only in very serious circumstances, such as psychiatric or cardiac illnesses where the impact of the information might lead to shock causing the patient's death or serious deterioration of the patient's state of health.

On the one hand, the autonomy of the patient demands that health care professionals inform patients adequately. On the other hand health-care professionals, owing to the time and effort needed to provide information, professional pride and other cultural and economic factors, are reluctant to inform the patient. This 'tug-of-war' explains the tendency of treatment providers to evade the burden of providing information by invoking the therapeutic exception freely.

The right not to know is another corollary of patient autonomy. The decision of the patient not to want to know must be respected. It is argued that the treatment provider is allowed to disclose information to the patient against the patient's will if otherwise the health of third parties or public health would be jeopardised.

Illustration 3

A patient is diagnosed as having hepatitis B after being admitted to hospital because of a persistent flu and yellow skin. The patient declares she does not want to be informed, invoking her right not to know. As hepatitis B can be transmitted through sexual intercourse, the attending physician decides to inform the patient nevertheless in order to protect the health of the patient's sex partner or partners.

In situations where the patient is unconscious and treatment must be performed immediately, it is not possible to provide information. The literature and case law overwhelmingly agree that informing the patient can be deferred to a later time.

C. Preferred option

The preferred option is that the therapeutic exception under paragraph (1)(a) should only be invoked if the treatment provider has very serious and decisive arguments to support it, in situations where the information would have a negative impact on the patient's life or health. This is especially the case with cardiac or mental diseases, where the shock and emotional stress resulting from the information might entail serious risks to the life or health of the patient. It should be noted, however, that the information should not be withheld from the patient's close family or parties authorised to take decisions on the patient's behalf. Another limit to the therapeutic exception is that it no longer applies when the objective circumstances on which the decision to withhold information from the patient was based cease to exist. In this case, the patient should be informed *a posteriori*.

The right not to know – paragraph (1)(b) – is recognised in so far as the lives, health and safety of third parties as well as public interest are not endangered by non-disclosure. The justification for this option lies in the autonomy of the patient.

Finally, if a patient is not able to consent to urgent treatment owing to unconsciousness or sensory impairment, the provision of information can be postponed until a later time when the patient is able to receive it, after treatment. People or institutions legally entitled to take decisions on behalf of the patient should be promptly informed. This is justified by practical considerations and it is a preliminary condition for consent to be given, as follows from IV.C.–8:108 (Obligation not to treat without consent) paragraph (3).

D. Burden of proof

The treatment provider will have to prove that exceptions to the obligation to inform existed and, in the case of paragraph (1)(a), to substantiate the existence of the objective conditions leading to the decision to withhold information under the therapeutic exception.

IV.C.–8:108: Obligation not to treat without consent

(1) The treatment provider must not carry out treatment unless the patient has given prior informed consent to it.

(2) The patient may revoke consent at any time.

(3) In so far as the patient is incapable of giving consent, the treatment provider must not carry out treatment unless:

(a) informed consent has been obtained from a person or institution legally entitled to take decisions regarding the treatment on behalf of the patient; or

(b) any rules or procedures enabling treatment to be lawfully given without such consent have been complied with; or

(c) the treatment must be provided in an emergency.

(4) In the situation described in paragraph (3), the treatment provider must not carry out treatment without considering, so far as possible, the opinion of the incapable patient with regard to the treatment and any such opinion expressed by the patient before becoming incapable.

(5) In the situation described in paragraph (3), the treatment provider may carry out only such treatment as is intended to improve the health condition of the patient.

(6) In the situation described in paragraph (2) of IV.C.–8:106 (Obligation to inform in case of unnecessary or experimental treatment), consent must be given in an express and specific way.

(7) The parties may not, to the detriment of the patient, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

This Article deals with one of the obligations of the treatment provider under a contract for the provision of treatment. It therefore presupposes the existence of such a contract. The obligation is a negative one but a crucially important one – not to carry out treatment without the informed consent of the patient. The obligation is a corollary to the obligation to inform. There would be no point in giving the patient all the required information if treatment could then be imposed on the patient in any event. The obligation protects the patient's right to self-determination. It is such a self-evident obligation in cases involving capable and conscious patients that it is difficult to think of examples where it would be deliberately ignored.

Illustration 1

Having concluded a contract for the treatment of his prostate cancer, a patient is informed that there is a 10 per cent chance of impotence after prostate surgery. The patient decides not to have surgery but to have drug treatment instead. It is obvious that the treatment provider cannot proceed with surgery without the patient's consent.

The contractual obligation not to proceed without the informed consent of the patient is re-inforced by the fact that there would usually be non-contractual and possibly criminal liability for invading a person's bodily integrity without that person's consent. Here, however, we are concerned only with the contractual obligation.

Another issue covered by this Article is the right of the patient to withdraw consent at any time (paragraph (2)). Even if the patient has previously provided consent for treatment, and treatment has already started, the patient can decide to withdraw consent at any given

time. Consent does not usually require a specific form and may be withdrawn freely at any time (CHRB art. 5 (General Rule)). This is a corollary of patient autonomy: regardless of the consequences, the directions of the patient must be followed.

Illustration 2

After prostate surgery, it appears that the patient has prostate cancer. He consents to radiotherapy and chemotherapy – which prove to have nasty side effects. After two months of reduced life quality due to constant discomfort because of vomiting, nausea, hair loss, etc., the patient decides to withdraw his consent to these treatments. He is free to do so.

The rule also deals with circumstances where the patient is not able to express consent (paragraph (3)); in such a case, a third party entitled to decide on behalf of the patient may give consent to the treatment. Depending upon the legal system concerned, this third party may be the parent of a minor, a guardian, a family counsellor or an administrative or judicial body. Specific procedures may exist in some jurisdictions. Also treatment may be given without consent or going through the necessary procedural steps if the treatment must be provided in an emergency. However, in all these cases the wishes of an incapable patient must be taken into account so far as possible, as well as any views expressed by the patient prior to the onset of incapacity. Such views may have been expressed in a formal document such as an advance Directive. Paragraph (5) provides that, if a third party must give consent on behalf of an incompetent patient, this consent can only be given to necessary treatment, not to optional or unnecessary treatment. Only treatment necessary to improve the health situation of the incompetent patient is allowed.

Illustration 3

A 12-year-old child has an illness that can be treated by surgery. There are some risks involved, but also substantial benefits. Under the relevant national law it is up to the child's parents to give consent, but at this age the child already can understand the question and decide. In some jurisdictions, it can be necessary for a court or another judicial or administrative body to make the decision on behalf of the incompetent patient. The opinion of the incompetent patient must be taken into account, though it is not binding.

Advance Directives, so-called living wills and previously expressed wishes must be taken into account whenever the patient will no longer be able to provide, or withdraw, consent to treatment. A patient can issue a set of instructions containing its preferences regarding its self-determination in case it loses at a later moment the capacity to decide Cf. CHRB art. 9 (Previously Expressed Wishes).

Illustration 4

Before undergoing a very delicate and high-risk operation, a patient declares that he refuses to be given life support if, as a consequence of the operation, he falls into a coma which appears to be permanent. The treatment provider must bear this preference in mind when deciding what to do.

The Article establishes a specific, more stringent regime for experimental treatment in paragraph (6), establishing that consent must be expressed and specific.

B. Interests at stake and policy considerations

The patient has the right, derived from his or her autonomy, to have treatment performed only in so far as he or she consented to it. Likewise, it is in the treatment provider's best interests to obtain consent, usually in the form of a document, in order to have a defence in the case of potential malpractice claims in the future. There is no controversy regarding the necessity of the patient's consent to treatment in normal circumstances.

The interests of patients who lack the capacity, because of either a permanent or temporary impediment, to decide and give consent must be safeguarded, as they are vulnerable. From a bioethics point of view, they should be given extended protection in order to prevent abuse or mistreatment: the treatment should be carried out only for their direct benefit (see CHRB arts. (Protection of persons not able to consent) and 7 (Protection of persons who have a mental disorder). Direct benefit will consist in treatment that will, from an objective medical point of view, improve or maintain the state of health of the vulnerable patient, thus excluding optional or unnecessary treatment such as cosmetic surgery or sterilisation. Treatments such as euthanasia should not be allowed. This may, however, be too restrictive in end of life situations (e.g. dysthanasia), and so the rule should be open-ended enough to encompass the latest developments in bioethics.

Illustration 5

A patient has been in a coma for a long period. He is kept alive by means of a life-support system. There are no reasonable prospects for recovery. Should this patient be kept on artificial life support for the rest of his life? This poses a complex ethical and legal problem. It is usually decided by the ethics committee of a hospital.

Illustration 6

A 15-year-old girl is prescribed the contraceptive pill. Such treatment can be considered unnecessary from a medical point of view.

In situations where the incompetent patient is not totally unable to understand the information provided, and to process it and decide on the basis of it, the accepted view in bioethics is that his or her wish or opinion be taken into account. A problematic issue is, however, the extent to which the opinion of such patients should be taken into account. Recorded statements of the patient's wishes before the onset of incapacity pose the same problems.

It is also accepted in bioethics that consent to scientific research must be given expressly and specifically, and be documented (CHRB art.16 (v) (Protection of persons undergoing

Research)). Consent should not be implied; it must be specific as regards that particular type of experimental treatment and be adequately documented in the clinical records, preferably in the patient's handwriting. It may, however, be argued that the requirement of written consent is too formal from a contract law point of view. Competent patients should be able to give their consent to clinical trials according to more stringent conditions aimed at protecting them.

Finally, there is a controversy about the right of the patient to refuse or withdraw from treatment. On the one hand, the patient's autonomy and right to self-determination should not be jeopardised. On the other hand, it is argued that the mission of the health-care provider is to heal, and therefore to impose treatment on the patient against his or her will if treatment will benefit the patient. So it is often argued by health-care practitioners and some sectors in society that treatment providers should override irrational, potentially self-destructive decisions of the patient which would be contrary to any objective medical recommendation.

C. Preferred option

Whenever capable patients are concerned, it is broadly accepted that their consent is essential for the treatment to be performed upon them. This is obviously right. So the general principle in paragraph (1) establishes that the treatment provider has an obligation not to perform treatment unless the patient has expressed his or her consent, after being provided with the necessary information. The expression of consent is the final phase of informed consent, and establishes the informed choice of the patient regarding treatment.

Consent does not require a specific form, and it can be withdrawn at any time (paragraph (2)) irrespective of whether, from an objective medical point of view, the decision is wrong or irrational. Although withdrawal may have a serious detrimental impact on the patient's health, this position is the only one coherent with the patient's right to self-determination in health matters. This right to withdraw from or to refuse treatment can, however, be limited by *lex specialis* of a public law nature in particular situations, such as compulsory vaccination, mental health regulations, compulsory treatment of highly infectious diseases which pose a public health problem (tuberculosis, leprosy, SARS, etc.) and other circumstances where the public interest prevails over individual rights.

According to paragraph (3), if the patient is incapable of giving consent, persons or institutions legally entitled to take decisions on behalf of the patient may give consent instead. Consent is to be given according to local rules and procedures applicable to such situations. Treatment may always be provided where this is necessary in an emergency. In so far as the patient has a limited ability to understand the circumstances in which treatment is to be performed, the patient's views and opinion about the treatment must be, so far as possible, be taken into account (paragraph (4)). Although in this case the opinion of the patient is not binding, it is relevant in so far as reasonable. The rule is open-ended in this aspect, as the relevance of the opinion of the patient can vary according to the concrete situation. The same reasoning applies to the decisions and preferences stated by patients before becoming incapable of giving informed consent.

The protection of vulnerable patients requires that the rule allows treatment to be performed on them in so far as it is presumed to be necessary for the improvement of their state of health. This prevents the potential abuse or mistreatment of patients who are in especially vulnerable situations (paragraph (5)). End-of-life issues are outside the scope of the civil law, and should be dealt with by public law regulation.

Regarding paragraph (6), although consent in a case of experimental treatment must follow a more stringent regime in order to protect patients, a written form is not deemed necessary unless it is required under public law rules or regulations. Consent in these circumstances must be express, specific for that experimental treatment and carefully documented (IV.C.–8:109 (Records)).

Finally, the parties may not, to the detriment of the patient, exclude the application of this Article or derogate from or vary its effect (paragraph (7)). The mandatory nature of the rule is justified by the fact that it is related to the protection of patients.

IV.C.–8:109: Records

(1) The treatment provider must create adequate records of the treatment. Such records must include, in particular, information collected in any preliminary interviews, examinations or consultations, information regarding the consent of the patient and information regarding the treatment performed.

(2) The treatment provider must, on reasonable request:

(a) give the patient, or if the patient is incapable of giving consent, the person or institution legally entitled to take decisions on behalf of the patient, access to the records; and

(b) answer, in so far as reasonable, questions regarding the interpretation of the records.

(3) If the patient has suffered injury and claims that it is a result of non-performance by the treatment provider of the obligation of skill and care and the treatment provider fails to comply with paragraph (2), non-performance of the obligation of skill and care and a causal link between such non-performance and the injury are presumed.

(4) The treatment provider must keep the records, and give information about their interpretation, during a reasonable time of at least 10 years after the treatment has ended, depending on the usefulness of these records for the patient or the patient's heirs or representatives and for future treatments. Records which can reasonably be expected to be important after the reasonable time must be kept by the treatment provider after that time. If for any reason the treatment provider ceases activity, the records must be deposited or delivered to the patient for future consultation.

(5) The parties may not, to the detriment of the patient, exclude the application of paragraphs (1) to (4) or derogate from or vary their effects.

(6) The treatment provider may not disclose information about the patient or other persons involved in the patient's treatment to third parties unless disclosure is necessary in order to protect third parties or the public interest. The treatment provider may use the records in an anonymous way for statistical, educational or scientific purposes.

COMMENTS

A. General idea

According to this Article, the treatment provider has an obligation to create, keep and keep up to date adequate records concerning the clinical history of the patient. This obligation aims at ensuring the correct performance of treatment, securing elements that may be important as evidence and promoting accountability. The reference to “adequate records of the treatment” assumes that the records will cover the anamnesis, the present health status of the patient, the way the illness developed, the therapeutic procedures followed, the medication, the obtaining of consent, the treatment performed, the names of the health-care professionals involved, etc. One reason for having an obligation to keep adequate records is that a patient may be seen by a number of different people at different stages and it is important that at each stage the treatment provider should know what has happened at earlier stages.

Illustration 1

A patient is admitted to a hospital after a skiing accident. Upon admission, a record will be created, and the time of admission noted down. The patient is taken to a physician in the emergency ward who is responsible for the assessment of the health status of patients and who refers them to specialists if necessary. The physician makes an initial diagnosis concluding that the patient has suffered a femoral fracture. The physician makes an initial diagnosis, concluding that the patient has suffered a femoral fracture. The physician notes down this information. The patient is taken to the orthopaedic ward, where a specialist orthopaedist proceeds to make a more thorough diagnosis. The orthopaedist confirms the initial diagnosis and orders an X-Ray examination. The X-Ray examination is done, the radiation exposure is recorded and the radiologist's name noted down. Next, the orthopaedist examines the X-ray films, which are attached to the records. She informs the patient that the leg is to be immobilised by means of a splint for one month and that she will prescribe anti-inflammatory and painkilling drugs to be taken during the first three days. The splint is put on by a nurse. The patient leaves the hospital, and is to return after one month. All these data are noted down in the clinical record, which also contains an account of the materials used and their costs for the processing of the invoices.

The Article also covers the patient's right to have full access to the records and to require the treatment provider to give reasonable assistance with their interpretation (paragraph (2)). This last point is important as records may use medical terms or abbreviations.

Paragraph (3) contains a specific presumption for treatment contracts. It applies when a patient has suffered injury and claims that it is a result of poor treatment. If the patient asks to see the medical records and the treatment provider does not provide them as required, it is presumed that the treatment provider failed to perform the obligation of skill and care and that there is a causal link between this non-performance and the injury. It is then up to the treatment provider to prove the reverse.

Records are to be kept for a reasonable time, according to paragraph (4), depending upon their usefulness.

The treatment provider is bound to secrecy concerning the records (paragraph (6)), with exceptions for cases where disclosure is necessary for the protection of third parties or the public interest. Likewise, anonymized data can be used for statistical, teaching or scientific purposes.

B. Interests at stake and policy considerations

Records are very important in order to be able to check the adequate performance of the contractual obligations. Apart from their methodological usefulness in the provision of treatment, records serve other purposes. They are important in the process of disclosure of information to the patient, especially in circumstances where the patient will want to evaluate the provision of the treatment. The medical records may also constitute the only source of information on which to base a lawsuit over malpractice, and will be of capital importance if a patient wishes to seek a second opinion or to be treated by another health-care professional.

It is generally recognised that the patient has the right to have access to his or her medical records as well as to obtain co-operation (even in the case of a claim against the treatment provider) from the treatment provider in their interpretation, according to applicable procedural rules. The records will be very important in order for the patient to assess the quality of treatment, and if necessary, essential elements in the substantiation of legal claims in case of non-performance of the obligations under the treatment contract.

It is debated whether the patient should have access to the entire record or only to the objective information included in it - that is, with the exception of notes of a personal, subjective nature. The latter may be highly prejudicial to the health-care provider in the context of a lawsuit. Another debate is whether the patient should have open access to the records or access only through a physician. It is argued, on the one hand, that a normal patient will not be able to understand the records and that full disclosure may not be to the advantage of the patient. On the other hand, it is argued that the patient should be granted full disclosure of all the records regarding his or her treatment and that involvement of a health-care professional and suppression of subjective notes by the treatment provider derive from a lack of transparency, paternalism and corporatism in health care.

Records may also be important in the future, serving as a basis for treatment to be performed on a patient. They may even be useful for several generations into the future (e.g. as regards genetic traits presenting a risk).

The issue of the quality of the records is very important. First of all, how detailed should the records be? Secondly, how accurate should they be? It is in the interest of the patient that they be thorough and accurate. Lack of thoroughness or accuracy may lead to non-performance of the contractual obligations.

Illustration 2

A patient is diagnosed as having a severe insufficiency of the renal function; her left kidney needs to be removed. The surgeon operating on the patient removes the right kidney owing to lack of clarity of the record created by the physician responsible for the diagnosis. In this case, the poor quality of the records contributed to the non-performance of the contractual obligation.

Even though accuracy is important, there is a price to pay: extensive record-keeping can be a difficult task for the treatment provider for time-management, organisational and budgetary reasons, whereas the possible gain for the patient may not always be very clear.

Illustration 3

A patient is treated for a toothache. The treatment itself takes 15 minutes, recording its details will take 30 minutes if every wad of cotton used in the administering of the treatment is to be accounted for. If such were the case, the costs of the health-care provision of health care would skyrocket.

So far as sanctions are concerned, records are *the* decisive element in the context of a claim for non-performance of the obligation of skill and care. In such circumstances, it may be argued that the treatment provider should be expected to provide the patient with sufficient information. If no records, or only incomplete records, are produced it may be argued that non-performance of the obligation should be presumed. This provides a powerful sanction for the keeping of adequate records. The lack or incompleteness of the medical record may be said to justify the reversal of the burden of proof in a liability claim. It may be argued, however, on the other hand that it is unrealistic to expect the treatment provider to act in such a way, as it would be against his interests.

A debated topic is the intensity of the obligation of the treatment provider to answer reasonable questions concerning the records. This obligation may affect the organisation of an institution, taking time away from more important duties. On the other hand, such information is important for the patient.

Another issue is during what period the treatment provider is to keep the records. It would be burdensome to keep records for a very long time, and there are costs involved in keeping them as well as providing information related to the records. So it is not to the

advantage of the treatment provider to require the records to be kept for a lengthy period. On the other hand, it would be in the patient's interest that they are kept for as long as possible, in order to enable future reference to be made to them or in order to judge the quality of treatment when an injury manifests itself after a long time. In some circumstances, the period would be very long indeed (as regards genetic information, for instance). A balance should be struck.

The treatment provider is under an obligation to keep the records secret. While this does not apply to third parties entitled to decide on behalf of the patient, doubts arise whether the treatment provider should be allowed to use or disclose data for statistical, educational or scientific purposes. On the one hand, the treatment provider and society have an interest in the development of medical science; on the other the patient's privacy and the privacy of other persons involved in the treatment (e.g. data obtained from family or friends that are needed for the treatment of the patient) are important considerations.

It is debated whether the treatment provider should be allowed in some circumstances to breach privacy and disclose information to third parties. It is argued that in situations where privacy could affect the life or health of third parties in a detrimental way, or in situations of public interest, those interests prevail over the patient's privacy. Examples might be the potential transmission of infectious diseases to third parties, or the suspicion of a criminal act being related to treatment performed on a person.

Problems may also arise in cases where an insurance company or an employer enters into a treatment contract with a doctor on behalf of the patient. The disclosure of medical data may be seriously disadvantageous to the patient.

C. Preferred option

The obligations to keep and maintain adequate records and make them available to the patient are recognised in the legal systems analysed, as is the obligation of confidentiality. The differences are in the subsidiary aspects of the obligations, such as the extent of disclosure required, the sanctions, and the exceptions to the obligation of confidentiality. The preferred option is to follow this general approach and to oblige the treatment provider to create adequate records, of a quality and thoroughness of which conform to the standard of care of the profession. It is also thought appropriate to oblige the treatment provider to disclose the records to the patient and to enable the patient (or a court of law or the relevant institution investigating and deciding upon malpractice claims) to interpret them. This is the general principle.

The presumption in paragraph (3) prevents a situation where the patient would be precluded from assessing the quality of treatment, and possibly from substantiating a claim, because the treatment provider had not performed the obligation to keep records or withheld information. Without records, it is virtually impossible for the patient to successfully claim a remedy for non-performance of the obligation of skill and care under these rules. This rule also has a deterrent role, as it prevents the treatment provider from

being lax as regards the obligation to keep records where it serves purposes other than securing evidence.

The treatment provider need only answer *reasonable* questions from the patient regarding the records. This prevents wasting the treatment provider's time and effort, while providing the patient with the information needed in order to evaluate the quality of performance of the obligations under the treatment contract.

As regards the time during which the treatment provider is to keep the records, the obligation under paragraph (4) varies according to the circumstances. Ten years is set as the reasonable minimum period, but a treatment provider may be required to keep the records for a longer time. In exceptional circumstances, where it may be important to keep the records for a longer time, the treatment provider is obliged to keep them. It is of no importance whether their prolonged keeping is of medical interest or otherwise serves the patient's interests or the general interest.

Illustration 4

An employee of a construction company is hospitalised because of a possible exposure to asbestos. The physician examining the patient cannot find evidence of any detrimental effects at that time. However, exposure to asbestos may lead to the development of malignant mesothelioma (a specific type of lung cancer attributed solely to sustained exposure to asbestos) decades later. Thus, the employee has an interest in the records being kept for a very long period, in order for him to be able to prove that exposure took place in the past, information which he will need to file a claim against his employer.

When the treatment provider ceases its activities, the records must either be deposited with another treatment provider or competent organisation or delivered to the patient or his heirs or representatives. This solution is a balanced one, and is justified by the possible importance of that information for the patient or relevant third parties even after an eventual action is time-barred.

Finally, it seems reasonable to allow the treatment provider to use or disclose the information contained in the records for statistical, educational or scientific purposes, in so far as they are used in an anonymous way. The treatment provider can also disclose information in order to protect third parties or the public interest in limited exceptional cases. The limit consists of the protection of the life or health of third parties that would otherwise potentially be endangered if disclosure did not take place. Disclosure is, however, not allowed to protect paternalistic interests of third parties, as these are not serious enough to warrant the sacrifice of secrecy, and such a breach might cause serious detriment to the patient (e.g. the loss of a job if data are disclosed to the employer).

The provisions of paragraph (1) to (4) are mandatory. Of course, the patient or the person or the institution entitled to take decisions on behalf of the patient may opt not to exercise or to waive the rights under paragraphs (2) or (4) but that is a different matter.

IV.C.–8:110: Remedies for non-performance

With regard to any non-performance of an obligation under a contract for treatment, Book III, Chapter 3 (Remedies for Non-performance) and IV.C.–2:111 (Client’s right to terminate) apply with the following adaptations:

- (a) the treatment provider may not withhold performance or terminate the contractual relationship under that Chapter if this would seriously endanger the health of the patient; and*
- (b) in so far as the treatment provider has the right to withhold performance or to terminate the contractual relationship and is planning to exercise that right, the treatment provider must refer the patient to another treatment provider.*

COMMENTS

A. General idea

The normal remedies for non-performance of an obligation provided by Book III, Chapter 3 apply in the case of obligations under a contract for treatment. The remedies include withholding of performance, damages, price reduction and termination of the contractual relationship for fundamental non-performance. The remedy of enforcing specific performance would also be available in theory but would be of restricted application in practice because of the personal nature of the obligations under a treatment contract. It could not be used, for example, to force a patient to undergo treatment (by enforcing the obligation to co-operate) but could be used by the patient to enforce an obligation to provide treatment if the patient so wished.

The right provided by IV.C.–2:111 (Client’s right to terminate) also applies in the context of a contract for treatment and enables the patient to terminate the contractual relationship at any time.

This Article contains two adaptations of the normal rules. The treatment provider may not withhold performance or terminate the contractual relationship or if doing so would cause serious harm to the health of the patient. Even if the treatment provider exercises these rights, there is an obligation to refer the patient to another treatment provider. In practice the only situations in which the treatment provider would be likely to withhold performance or terminate the contractual relationship would be where the patient was not performing the obligation to co-operate or had repudiated the contract by stating in advance that there would be no payment.

B. Interests at stake and policy considerations

It is debated whether the treatment provider should be allowed to terminate the contractual relationship or withhold performance if the patient fails to perform reciprocal obligations under the contract – normally the obligations to co-operate and pay. On the one hand, it is argued that this right should not be exercised if that fact would, from an objective point of view, seriously endanger the health situation of the patient. On the other hand, not allowing the treatment provider to terminate the relationship or to withhold performance would excessively bind the treatment provider to the contract, not even allowing termination for a repudiation or fundamental non-performance by the patient. This could seem particularly hard in those cases, such as cosmetic surgery, where termination would not affect the patient's health.

In several legal systems, there are restrictions on the treatment provider's right to terminate the contractual relationship. It is generally accepted that the patient can terminate the relationship at any time and with no reason.

C. Preferred option

The preferred option is to limit but not remove the treatment provider's remedies of withholding performance or terminating the contractual relationship. The treatment provider is not allowed to exercise these remedies if the health of the patient would be seriously endangered by the consequences, i.e. the suspension or cessation of medical care administered by that specific treatment provider. The physical integrity of the patient is considered to be more important than the contractual freedom of the treatment provider and as such prevails. Even where the treatment provider is allowed to withhold performance or terminate, there is an obligation to refer the patient to another provider. The patient should not simply be left without anywhere to go.

No adaptations are considered necessary in relation to the patient's right to terminate the contractual relationship at any time under IV.C.–2:111 (Client's right to terminate). The normal restitutionary effects will follow. This means, among other things, that the patient would normally have to pay for any examinations or tests already carried out. The patient would not be allowed to obtain these for nothing and take them to another treatment provider. Under IV.C.–2:111 (Client's right to terminate) paragraph (3) the client who terminates without any ground to do so may be liable to pay damages for any loss suffered by the service provider. However, in the case of a treatment contract there is unlikely to be any such liability for damages because performance of the contractual obligation to treat would have been dependent in any event on the client's consent.

IV.C.–8:111: Obligations of treatment-providing organisations

(1) If, in the process of performance of the obligations under the treatment contract, activities take place in a hospital or on the premises of another treatment-providing organisation, and the hospital or that other treatment-providing organisation is not a

party to the treatment contract, it must make clear to the patient that it is not the contracting party.

(2) Where the treatment provider cannot be identified, the hospital or treatment-providing organisation in which the treatment took place is treated as the treatment provider unless the hospital or treatment-providing organisation informs the patient, within a reasonable time, of the identity of the treatment provider.

(3) The parties may not, to the detriment of the patient, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

It commonly happens in some countries that health-care professionals without an employment contract with or a functional link to a hospital are allowed by that hospital to administer treatment on its premises. This situation may result in uncertainty about the legal rights of patients. The idea underlying this Article is that a treatment-providing organisation, such as a hospital or an asylum, should make its own position clear and should inform the patient of the identity of the treatment provider. If the treatment provider cannot be identified the organisation will be treated as the treatment provider.

Illustration

A patient has light surgery in a hospital. A doctor within the premises of the hospital attends him. The surgery leaves an ugly scar. The patient seeks an explanation, but the hospital declines any responsibility as the patient did not conclude the contract with the hospital, but with an independent doctor acting within its premises. The patient demands to be informed about the identity of the doctor, but the hospital administration has no information and the patient cannot remember the doctor's name, as he was convinced that he was an employee of the hospital. This Article applies.

B. Interests at stake and policy considerations

Many cases of failure to perform obligations under treatment contracts arise in the context of a complex treatment-providing organisation, such as a hospital or an asylum. Health-care professionals who are not employed by the organisation very often perform treatment on its premises, and uncertainties may arise because of that. Similarly, non-performance of the treatment obligations is often caused by problems in the administration and organisation of such institutions or by defects in their equipment or premises.

From the patient's point of view, it would be highly desirable if there was no need to be bothered by organisational issues of which he or she could not reasonably be expected to be aware. On this view, the patient should be able to bring a claim for non-performance against the hospital or asylum regardless of whether that hospital or asylum is the

contracting party itself or only the place where the independent treatment provider operates. It can be argued that, for the sake of certainty and patient protection, such a regime would be desirable. The difficulties of identifying the professional involved and sorting out responsibilities if various causes contributed to the non-performance make it extremely difficult for the patient to bring a claim. So a rule imposing central liability on the organisation could directly benefit patients. Another advantage of such a rule might be to enhance prevention, as the hospital or other similar institution would engage itself actively in the organisation and supervision of the activities of its professionals. The financial problems posed by such a regime to small treatment-providing organisations could possibly be overcome or alleviated by compensation funds pooling.

On the other hand it is argued that such a stringent regime would have serious financial consequences for hospitals which to a great extent rely on freelance health-care professionals. Insurance premiums would probably rise.

Another position is that such a rule should not operate automatically, but only if the liable freelance professional cannot be identified in a similar way to what is provided by Article 3(3) of Directive 85/374/EEC of the European Council regarding liability for defective products.

C. Preferred option

Implementing full-fledged central liability of treatment providing organisations is not deemed desirable; such central liability would have too high an economic impact on small hospitals. Moreover, this would lead to conceptual problems regarding the extension of liability to an institution which was not a party to the contract, albeit that it benefited from that contract and permitted the contractual party to act within its premises.

However, in balancing the interests involved, it seems not unreasonable to provide that the patient who suffers from a non-performance of obligations under the contract is entitled to some assistance from the treatment-providing organisation in identifying the party liable for the non-performance. The preferred option is therefore to oblige the treatment-providing organisation to indicate, at the patient's request, who is the contracting party. If it fails to provide the patient with the identity of the individual treatment provider within a reasonable time after being so requested, it is regarded as being the contracting party and may be held liable for non-performance.

Moreover, the patient is entitled to know who the contractual counterpart is before the contract is being performed. Paragraph (1) of the present Article therefore requires the treatment providing organisation to make clear to the patient that it is not the contractual party, and that treatment will be performed by an independent, autonomous healthcare professional acting within its premises.

PART D. MANDATE

CHAPTER 1: GENERAL PROVISIONS

IV.D.–1:101: Scope

- (1) *This Part of Book IV applies to contracts (mandate contracts) under which:*
- (a) *a person, the representative, is authorised and instructed (mandated) by another person, the principal, to conclude a contract between the principal and a third party or otherwise affect the legal position of the principal in relation to a third party; and*
 - (b) *the representative undertakes, in exchange for a price, to act on behalf of, and in accordance with the directions of, the principal.*
- (2) *This Part applies only to the internal relationship between the principal and the representative (the mandate relationship). It does not apply to the relationship between the principal and the third party or the relationship between the representative and the third party.*
- (3) *This Part applies with appropriate adaptations:*
- (a) *to contracts and unilateral juridical acts under which the representative is to represent the principal otherwise than in exchange for a price;*
 - (b) *to contracts under which the representative is instructed to, and undertakes to, perform the obligations which are meant to lead to the conclusion of the prospective contract but in which the representative is not authorised from the start to actually conclude that prospective contract; and*
 - (c) *to contracts and unilateral juridical acts under which the representative is merely authorised but not instructed or obliged to act, but nevertheless does act.*
- (4) *Contracts to which, in accordance with paragraph (3)(b), this Part applies and to which Part C (Services) of this Book applies, are to be regarded primarily as mandate contracts.*
- (5) *This Part does not apply to mandate contracts pertaining to investment services and activities as defined by Directive 2004/39/EC, OJ L 145/1, as subsequently amended or replaced.*

COMMENTS

A. General

This Article indicates the scope of this Part of Book IV. The main application is to contracts (mandate contracts) by which a representative is mandated (that is, authorised and instructed) to affect the legal relations between the other party to the mandate contract (the principal) and a third party, for instance by negotiating and concluding a contract on behalf of the principal, and undertakes to take on the task in exchange for a price (paragraph (1)). A typical example would be a contract between an estate agent and a client for the negotiation and conclusion of the purchase or sale of a house. The Part applies only to the internal relationship between principal and representative (paragraph

(2)). Paragraph (3) enlarges the scope of application of the rules on mandate to certain other very similar situations. Paragraph (4) excludes the application of these rules to investment services contracts.

B. External relationship not covered

This Part is concerned with the contractual obligations between the principal and the representative only (paragraph (2)). This Part does not relate to the question whether or not the 'prospective' contract with the third party is valid or invalid: that question is governed by Book II, Chapter 6 on Representation. That Chapter deals only with the relationship between the principal and the third party (external relationship); it explicitly leaves the internal relationship between the principal and the representative to the Part on Mandate (see II.–6:101 (Scope) paragraph (3) and Comment C on that Article).

C. Entitlement and obligation

The first paragraph clarifies that the characteristic elements of a mandate contract are (a) that the representative is authorised and instructed to conclude a contract between the principal and a third party and (b) that the representative undertakes to act on behalf of and in accordance with the directions of the principal in that matter. There is both an entitlement and an obligation to act on behalf of the principal.

The fact that the representative is authorised and instructed to act on behalf of the principal implies that the exercise of a mandate and the legal consequences thereof in the external relationship are based on the free will of the principal. By authorising the representative, the principal consents to the representative concluding a contract on the principal's behalf. The authorisation also implies that where the representative respects the limits indicated in the mandate and acts in accordance with the provisions in this Part, the representative may not be held liable for concluding a contract with the third party which turns out to be detrimental to the principal: by consenting to the representative acting the principal assumes that risk. By instructing the representative, the principal indicates that the representative is to make appropriate efforts to conclude the prospective contract. Again this stresses that the principal's will is controlling: the principal it is not simply leaving it to the representative to decide whether or not to take any steps.

The fact that the representative undertakes to act on behalf of the principal and to follow the principal's directions in relation to the task undertaken means that the representative is under a legal obligation to at least attempt to conclude the prospective contract. By concluding the mandate contract the representative therefore undertakes an obligation to act.

D. Direct and indirect mandate

In mandate relationships the representative acts on behalf of the principal, irrespective of whether in the relationship with the third party the representative acts in the principal's name or otherwise in such a way as to indicate an intention to bind the principal (direct mandate) or uses the representative's own name or otherwise acts in such a way as not to indicate an intention to bind the principal (indirect mandate).

E. Prospective contract or other legal effects

This Part will typically apply to mandate relationships in which the representative is mandated to conclude a contract on behalf of the principal, the second contract being referred to as ‘the prospective contract’, as defined in IV.D.–1:102 (Definitions) paragraph (1)(c). However, occasionally the representative will not be mandated to conclude a contract, but to otherwise affect the legal relations of the principal.

Illustration 1

A lawyer is instructed to raise an action for damages against another party. In this particular situation, when raising the action the representative actually does intend to affect the legal relations of the principal with the third party, but not by concluding a contract with that third party. Such mandate contracts are covered by the present Part.

F. Application to remunerated and gratuitous contracts

Paragraph (1)(a) indicates that the present Part applies primarily to mandate contracts by which the representative is to be rewarded for the services. Paragraph (3)(a) indicates that it also applies to gratuitous mandate services, but that adjustments may be necessary in order to take into account that the representative was acting without remuneration. In the case of gratuitous mandate contracts, one could for instance imagine that the standard of care and skill expected under IV.D.–3:103 (Obligation of care and skill) will be lower and the obligation to inform the principal of the progress of the performance of the mandate contract and the obligation to give account more restrictive than would be the case for a remunerated mandate contract. Moreover, IV.D.–2:103 (Expenses incurred by representative) paragraph (2) in particular applies where the parties have agreed upon the mandate contract being performed gratuitously. The reference to unilateral juridical acts in paragraph (3)(a) is inserted to cover the case of a mandate for representation (typically gratuitous in such situations) which takes the form of a unilateral grant of authority (power of attorney). Very often there will be an underlying mandate contract in such cases or a mandate contract will come into existence when the representative agrees to act either explicitly or implicitly by actually beginning to act. However, for the avoidance of doubt and to fill any potential gaps the express reference to unilateral acts is included. See also paragraph (3)(c).

G. Extension to provisional mandate contracts

Paragraph (3)(b) and (c) extend the scope of application of this Part to two types of contracts which, under the general provision of paragraph (1), could otherwise not be qualified as mandate contracts, whereas they in reality closely resemble the relationship between a principal and a representative under a mandate contract. Extension of this Part to these contracts is necessary, in particular, to prevent the stronger party from escaping from the mandatory rules of Chapter 6 of this Part by withholding either the authorisation of the representative to conclude the prospective contract from the start (paragraph (3)(b)), or by merely authorising but not requiring the representative to act (paragraph (3)(c)).

Under paragraph (3)(c), the rules on mandate are to apply to contracts which are intended to lead to the conclusion of the prospective contract, but in which the representative is not authorised from the start to actually conclude that prospective contract (“provisional mandate contracts”).

Illustration 2

An estate agent is instructed to find a buyer for the principal’s house. The agent succeeds in finding a buyer and only then is authorised by the principal to conclude the sales contract on the principal’s behalf.

Under paragraph (1) of IV.D.–1:101 (Scope), the contract between the estate agent and the owner of the house can only partly be covered by the Part on mandate contracts: only once the estate agent has found a buyer is the agent authorised to sell it to that buyer. Only that latter transaction could then be seen as mandate, whereas the former transaction – ‘find me a buyer for my house’ – would not be covered by this Part, but most likely would be classified as a service under IV.C.–1:101 (Supply of a service). This makes the whole contract between agent and owner a mixed contract under II.–1:108 (Mixed contracts).

Paragraph (4) provides that “provisional mandate contracts” fall primarily within the category of mandate contracts, notwithstanding that they contain a strong service element. Under II.–1:108 (Mixed contracts) paragraph (3) a mixed contract may fall primarily within one category, if a rule provides so. This is indeed the chosen solution in this case, since the purpose of the whole contract is to bring about a contract between the principal and a third party, the whole contract falls under the definition of a mandate contract.

There are good reasons for enlarging the application of the mandate rules as is done by paragraph (3)(b). Whereas the Part on mandate includes mandatory rules, in particular regarding termination (Chapter 6), the provisions of Book IV.C. on service contracts hardly contain any mandatory rules. It should be noticed that by not including these contracts, there is a substantive risk that the stronger party – be it the representative or the principal – would ‘cut the mandate contract in parts’ and thus be protected from the applicability of the mandatory rules of this Part. In any case, this would invite parties to litigate the matter whether in fact a mandate contract was concluded or whether there really were two separate contracts. Moreover, application of the provisions of this Part may also be useful in the situation of non-performance of the contractual obligations by the representative, as the present Part sets out more concretely what may be expected of the representative than the – necessarily more abstract – provisions of the general provisions of the Part on service contracts (Book IV.C, Chapters 1 and 2).

Paragraph (3) (e), when read with paragraph (3)(b), cover provisional mandate contracts in which the representative is ultimately not authorised to conclude the prospective contract. In this particular case, the agent has actually performed most of the obligations under a ‘provisional mandate contract’, but could not conclude the prospective contract

because the principal did not grant authorisation, even though the initial intention of the parties was to conclude a mandate contract. If this contract could not be classified as a mandate contract, it must be classified as a services contract. The Part on service contracts, however, does not provide such specifically adapted rules as to when the contractual relationship is terminated and what should happen with the representative's entitlement to payment. For these reasons, it is thought that the application of the rules of this Part better suits the interests of both parties. Moreover, as paragraph (4) provides, application of this Part prevents the stronger party from circumventing the mandatory rules in this Part by splitting up the contract.

Illustration 3

An estate agent undertakes to attempt to sell a house on behalf of its owner. The agent finds a buyer for the price indicated by the owner, but the owner nevertheless refuses to mandate the agent to actually sell the house and sells the house herself. In doing so, she hopes to escape having to pay the representative the price for the services provided. As paragraph (3)(b) qualifies this contract as a mandate contract, and paragraph (4) provides that the provisions of this Part take priority over those in Book IV Part C, this attempt fails.

H. Application to contracts without obligation to act

The rules on mandate apply primarily to contracts by which the representative is not only authorised but also instructed and obliged to act on behalf of the principal. Paragraph (3)(c) extends the scope of this Part, with any appropriate adaptations, to contracts and unilateral juridical acts by which the representative is authorised but not instructed or obliged to act on behalf of the principal. Obviously, this provision is of relevance when the representative indeed acts on behalf of the principal.

I. Investment services and activities not covered

Paragraph (5) indicates that mandate contracts falling within the scope of paragraphs (1) and (3) are nevertheless exempted from the application of this Part if they pertain to investment services and activities. The reason for the limitation of the scope of the Part in this respect is that these mandate contracts are regulated by specific legal instruments, which are of a very different nature and to a large extent introduce public law requirements and supervision. These mandate contracts therefore differ so much from ordinary mandate contracts that application of the provisions of this Part would be restricted to extraordinary situations for which the public law regulations do not provide a solution, which would make the application of this Part merely accidental. In case there were such a need, a court could of course apply this Part by way of analogy, but these rules do not claim application by themselves.

J. Contracts for the administration of affairs not covered

Traditionally, contracts for the administration of affairs are covered by provisions on mandate contracts. In these general mandate contracts, the representative is not necessarily instructed to conclude a prospective contract, but merely to administer the affairs of the principal. Such contracts can therefore not be considered mandate contracts

in the sense of this Part; they fall within the scope of the Part on service contracts and may occasionally be governed more specifically by the Chapter on storage (Book IV.B, Chapter 5) and possibly by the Chapter on processing (Book IV.B, Chapter 4). However, in performance of the obligations under such a contract, the service provider often has to affect the legal relations of the principal – e.g. when the principal’s property must be sold as part of the administration to safeguard the principal’s interests. Where in the course of a contract of administration the service provider is required to buy or sell goods, the present Part may be applied by virtue of the rules on mixed contracts in II.–1:108 (Mixed contracts).

IV.D.–1:102: Definitions

In this Part:

- (a) the ‘mandate’ of the representative is the authorisation and instruction given by the principal as modified by any subsequent direction;***
- (b) the ‘authority’ of a representative is the power to affect the principal’s legal position;***
- (c) the ‘prospective contract’ is the contract the representative is authorised and instructed to conclude on behalf of the principal and any reference to the prospective contract includes a reference to any other juridical act which the representative is authorised and instructed to do on behalf of the principal;***
- (d) a mandate for direct representation is a mandate under which the representative is to act in the name of the principal, or otherwise in such a way as to indicate an intention to affect the principal’s legal position;***
- (e) a mandate for indirect representation is a mandate under which the representative is to act in the representative’s own name or otherwise in such a way as not to indicate an intention to affect the principal’s legal position;***
- (f) a ‘direction’ is a decision by the principal pertaining to the performance of the obligations under the mandate contract or to the contents of the prospective contract that is given at the time the mandate contract is concluded or, in accordance with the mandate, at a later moment;***
- (g) the ‘third party’ is the party with whom the prospective contract is concluded by the representative on behalf of the principal;***
- (h) the ‘revocation’ of the mandate of the representative is the decision of the principal to no longer authorise and instruct the representative to act on behalf of the principal.***

COMMENTS

A. General

The most important concepts used in this Part are defined in the present Article. The Article itself does not contain any substantive rules.

B. Some definitions taken over from rules on external relationship

Book II Chapter 6 on Representation contains definitions of concepts that are relevant to the external relationship between a principal and a third party (see II.–6:102 (Definitions)). Some of these concepts are also relevant to the internal mandate relationship and are repeated in this Article. These are the concepts of authority, representative, third party and mandate of the representative. These concepts are discussed in the Comments to II.–6:102.

C. Definition of ‘third party’

The concept of ‘third party’ as such is not defined under II.–6:102 (Definitions). Paragraph (5) of that Article merely provides that where the representative (as a representative) concludes the prospective contract between the principal and himself or herself in a personal capacity, for the purposes of Book II, Chapter 6, the representative is to be regarded as the ‘third party’. The same would apply under sub-paragraph (g) of this Article.

IV.D.–1:103: Duration

A mandate contract may be concluded:

- (a) for an indefinite period of time;*
- (b) for a fixed period; or*
- (c) for a particular task.*

COMMENTS

A. General idea

This Article provides a classification of mandate contracts from the point of view of duration. Three types of contracts are distinguished: contracts for an indefinite period, contracts for a fixed period and contracts for a particular task. In the mandate contract it may be indicated that the mandate relationship is destined to terminate at a specific moment in time irrespective of the individual will of the parties, i.e. a contract for a definite period. That specific moment for termination may be a fixed date agreed upon by the parties (sub-paragraph (b)) but may also be the moment in which the particular task that the representative has to fulfil has been achieved (sub-paragraph (c)). Where no such specification exists, the mandate contract is concluded for an indefinite period of time (sub-paragraph (a)).

B. Specificities of mandate contracts for a particular task

Contracts for a particular task are considered in the present Part as contracts for a definite period because the parties agree that their mandate relationship terminates when the particular task the representative was to fulfil has been achieved. However, differing from mandate contracts for a definite period in which a fixed date is agreed, in contracts for a particular task it may be uncertain when the envisaged result will be achieved or even whether it will be finally achieved. This implies that in the case of a mandate contract for

a particular task, the parties may de facto be linked in a mandate relationship for an indefinite period.

IV.D.–1:104: Revocation of the mandate

(1) Unless the following Article applies, the mandate of the representative can be revoked by the principal at any time by giving notice to the representative.

(2) The termination of the mandate relationship has the effect of a revocation of the mandate of the representative.

(3) The parties may not, to the detriment of the principal, exclude the application of this Article or derogate from or vary its effects, unless the requirements of the following Article are met.

COMMENTS

A. General idea

This Article makes it clear that the principal is free to revoke the mandate given to the representative at any time. This may be done explicitly, by giving notice of revocation (paragraph (1)), but a mandate of the representative may also be revoked implicitly: as a consequence of the conclusion of the prospective contract by the principal or another representative appointed by the principal (paragraphs (2)) or as a consequence of the termination of the mandate relationship (paragraphs (3)).

The parties may not agree to exclude this right for the principal, unless the exceptional circumstances set out in IV.D.–1:105 (Irrevocable mandate) are met.

B. Notice of revocation always effective

As a general rule, the principal is free to decide that the representative is no longer to be authorised to act on the principal's behalf. The principal may revoke the mandate at any time by giving notice to the representative, even if the mandate contract was concluded for a fixed period or a particular task.

C. Revocation by termination of the mandate relationship

If the relationship terminates, the mandate of the representative also comes to an end. As follows from Chapters 6 and 7, termination may take place by notice, but also when the prospective contract is concluded and when the representative dies. Termination therefore does not always imply that notice of termination is given.

D. Revocation is not a breach of the principal's duty to co-operate

The revocation of the mandate implies that the principal effectively prevents the representative from performing the obligations under the mandate contract and thereby from earning any stipulated remuneration. As such, this could be considered as a non-performance by the principal of the obligation to co-operate (with the possibility of the

representative claiming specific performance of the right to continue to affect the legal effects of the principal). However, as paragraph (1) explicitly gives the principal the right to revoke the mandate, this cannot be seen as the proper consequence of the revocation. The present Article, in this respect, therefore derogates from the general duty to cooperate under III.–1:104 (Co-operation).

E. Conditions to be observed only relevant to liability in damages

Revocation of the mandate of the representative implies termination of the mandate relationship. The conditions that are to be fulfilled by the principal when terminating the relationship, namely to have an extraordinary reason to revoke which justifies immediate termination and to observe a reasonable period of notice, are to be observed when the principal wants to revoke. These conditions are not necessary for a revocation to be effective, but are relevant as to the determination of the liability in damages of the principal.

IV.D.–1:105: Irrevocable mandate

(1) In derogation of the preceding Article, the mandate of the representative cannot be revoked by the principal if the mandate is given:

(a) in order to safeguard a legitimate interest of the representative other than the interest in the payment of the price; or

(b) in the common interest of the parties to another legal relationship, whether or not these parties are all parties to the mandate contract, and the irrevocability of the mandate of the representative is meant to properly safeguard the interest of one or more of these parties.

(2) The mandate may nevertheless be revoked if:

(a) the mandate is irrevocable under paragraph (1)(a) and:

(i) the contractual relationship from which the legitimate interest of the representative originates is terminated for non-performance by the representative; or

(ii) there is a fundamental non-performance by the representative of the obligations under the mandate contract; or

(iii) there is an extraordinary and serious reason for the principal to terminate under IV.D.–6:103 (Termination by principal for extraordinary and serious reason); or

(b) the mandate is irrevocable under paragraph (1)(b) and:

(i) the parties in whose interest the mandate is irrevocable have agreed to the revocation of the mandate;

(ii) the relationship referred to in paragraph (1)(b) is terminated;

(iii) the representative commits a fundamental non-performance of the obligations under the mandate contract, provided that the representative is replaced without undue delay by another representative in conformity with the terms regulating the legal relationship between the principal and the other party or parties; or

(iv) there is an extraordinary and serious reason for the principal to terminate under IV.D.–6:103 (Termination by principal for extraordinary and serious

reason), provided that the representative is replaced without undue delay by another representative in conformity with the terms regulating the legal relationship between the principal and the other party or parties.

(3) Where the revocation of the mandate is not allowed under this Article, a notice of revocation is without effect.

(4) This Article does not apply if the mandate relationship is terminated under Chapter 7 of this Part.

COMMENTS

A. General

Under the preceding Article the general rule is that mandate contracts are freely revocable at any time. However, there may be situations where either the representative or other parties have a legitimate interest in the *irrevocability* of such a mandate. This question is dealt with in the present Article. It sets out under the circumstances in which a mandate, in derogation of the normal situation as set out in IV.D.–1:104 (Revocation of the mandate) may be irrevocable.

B. Possible situations for irrevocability

The fundamental right to revoke a mandate touches upon the right of the principal not to be bound by a prospective contract (or other juridical act) if the principal no longer wishes to become bound. However, in certain cases there are also legitimate interests of other parties at stake. These interests may conflict with the principal's interest not to be bound by a prospective contract or other juridical act.

This provision differentiates two situations in which the interests of other parties justify the existence of an irrevocable mandate. In the first case, the mandate serves to execute a legitimate interest of the representative. Irrevocability may be needed to safeguard that interest of the representative. The irrevocability thus exists *towards the representative*. In the second case, the mandate is to serve the interests of several 'principals' and irrevocability is needed to safeguard the interests of the principals *towards each other*. These situations have in common that they are the result of an underlying relationship between the principal and the representative or other interested parties.

C. Mandate given in the interest of the other party

In this type of case covered by paragraph (1)(a), the underlying relationship may give rise to an irrevocable mandate where the mandate serves to execute an interest of the representative.

Illustration 1

A bank is willing to award a credit contract to a consumer, provided that it is secured by a mortgage on the house of the consumer. In the credit contract the

consumer agrees to award an irrevocable mandate to the bank to establish the mortgage.

D. Mandate given in the interest of several ‘principals’

In this situation, covered by paragraph (1)(b) several parties agree that in the interest of an efficient and effective representation of their interests or in the interest of solving a common problem, a mandate is to be given to one of them or to a third party to act as a representative on behalf of all of them. In this case, on the basis of their common relationship, the ‘principals’ are bound towards each other not to revoke the mandate. In the relationship between each principal and the representative, this may lead to the irrevocability of the mandate.

Illustration 2

A group of music composers (principals) agree that in their common interest an organisation of music composers (representative) will be mandated to act on their behalf with regard to the exploitation of their intellectual property rights.

Illustration 3

Two co-owners of a car mandate each other to sell the car to an interested third party. Here, both co-owners may act independently on their own behalf and that of their fellow co-owner.

In these examples, irrevocability does not follow from the relationship between the co-owners. Therefore, the parties must agree thereupon.

Illustration 4

A buyer and a seller (principals) disagree as to whether the delivered goods conform to the contract. They appoint an arbitrator (representative) to decide who is right.

In this illustration the common interest of the principals consists of solving their conflicting interests and the solution is to be achieved by a third party. If this is the case, the representative necessarily must be somebody else. It follows from the nature of the relationship between these parties that the mandate of the representative must be irrevocable: a party who is dissatisfied with the intermediate decision of the arbitrator should not be able to revoke the arbitrator’s mandate and thus escape from a negative outcome of the dispute. As the arbitrator is ‘to affect the legal relations of the principal’, the contracts between the arbitrator and the two principals fall under the definition of the mandate contract.

E. Exceptions to irrevocability

Only when the reason for irrevocability of the mandate under the underlying relationship no longer exists may the principal revoke the mandate of the representative. In this sense, the ‘irrevocability’ is relative.

Irrevocability in the interests of representative. Even when the mandate is irrevocable and the period of irrevocability has not yet elapsed, the representative is still required to act in accordance with the mandate, to act in the best interests of the principal and to act in accordance with the standard of care that may be expected. The irrevocability of the mandate should not go so far as to prevent the principal from terminating the mandate relationship for fundamental non-performance by the representative of the obligations under the mandate contract (paragraph (2)(a)(ii)). The mandate can also be revoked if the relationship from which the legitimate interest originates is terminated for non-performance by the representative (paragraph (2)(a)(i)). Finally, the principal may revoke the mandate if there is a serious and extraordinary reason to terminate the mandate relationship (paragraph (2)(a)(iii)).

2. Irrevocability in the interests of other principals. If the principals agree that the mandate may be revoked (paragraph (2)(b)(i)) or if the underlying contractual relationship has terminated (paragraph (2)(b)(ii)) or if the representative commits a fundamental non-performance (paragraph (2)(b)(iii)), the principal is free to revoke the mandate of the representative. The principal may also revoke the mandate if there is a serious and extraordinary reason to terminate the mandate relationship (paragraph (2)(b)(iv)). In these latter cases, the representative is to be replaced without undue delay by another representative in conformity with the contract between the principal and the other party or parties.

F. Consequences of irrevocability

To the extent that the mandate is irrevocable, a notice of revocation by the principal remains without effect (paragraph (3)). It does not end the authority of the representative to represent the principal, and therefore the mandate relationship is not terminated.

G. Termination under Chapter 7 leads to revocation of mandate

If the mandate relationship terminates because one of the situations under Chapter 7 occurs, i.e. the contract is concluded, the fixed period expires or the relationship is terminated because the representative dies, the rules on irrevocability no longer have effect. This is also the case when the principal dies and the successors of the principal or the representative terminate the contractual relationship on the basis of an extraordinary and serious reason.

CHAPTER 2: MAIN OBLIGATIONS OF THE PRINCIPAL

IV.D.–2:101: Obligation to co-operate

The obligation to co-operate under III.–1:104 (Co-operation) requires the principal in particular to:

(a) answer requests by the representative for information in so far as such information is needed to allow the representative to perform the obligations under the mandate contract;

(b) give a direction regarding the performance of the obligations under the mandate contract in so far as this is required under the mandate contract or follows from a request for a direction under IV.D.–4:102 (Request for direction).

COMMENTS

A. General idea

This provision is a specification of the general rule in III.–1:104 (Co-operation) which imposes on the parties an obligation to co-operate with each other when this can reasonably be expected for the performance of the other party's obligations. Under the present Article, the obligation to co-operate requires the principal, in particular, to provide the representative with information and directions in order to allow the representative to perform the obligations under the mandate contract.

B. Reasonable requests by representative for information

This provision does not impose on the principal an obligation to voluntarily provide information to the representative. The principal may not always know what information the representative needs. The principal is only obliged to answer requests by the representative for information when it is reasonable to expect that such information will enable the representative to perform the obligations under the mandate contract.

C. Obligation to give directions

According to the present provision, the principal is obliged to provide “subsequent” directions to the representative as to the performance of the obligations under the mandate contract or the content of the prospective contract in two cases: when such an obligation is imposed in the mandate contract, and when the representative is obliged to ask for a direction, (as regulated in IV.D.–4:102 (Request for a direction) paragraph (1)). If the representative is obliged to ask for a direction in order to find out the position of the principal on the issue pertaining to the performance of the obligations under the mandate contract or the content of the prospective contract, it is a logical consequence that the principal is obliged to answer such requests.

D. Consequences of failure to provide answers to request for information

If the principal is under a contractual obligation to answer the requests of the representative, the failure to provide such answers would constitute a non-performance of the obligation. The principal could be required to compensate the representative for any damage sustained as a result (e.g. the loss of the profit of the performance of another contract, as the performance of this particular contract has taken more time than expected). However, such damages do not solve the representative's problem completely, as the representative does not know how to further perform the obligations. It could

therefore be useful to allow the representative to proceed and base performance on the expectations, preferences and priorities a normal principal would have.

In so far as the principal's interests are not communicated to the representative and the representative could not be expected to be aware of these interests otherwise, the representative cannot be expected to take them into account. Not taking these interests into account therefore does not lead to non-performance of the obligations under the mandate contract by the representative. This therefore constitutes a defence for the representative.

E. Consequences of failure to provide directions

The consequences of a failure to provide directions are regulated extensively under IV.D.-4:103 (Consequences of failure to give a direction).

IV.D.-2:102: Price

(1) The principal must pay a price if the representative performs the obligations under the mandate contract in the course of a business, unless the principal expected and could reasonably have expected the representative to perform the obligations otherwise than in exchange for a price.

(2) The price is payable as of the moment the representative has affected the legal relations of the principal in accordance with the mandate contract and given account of that.

(3) If the parties had agreed on payment of a price for services rendered, the mandate relationship has terminated and the prospective contract has not been concluded, the price is payable as of the moment the representative has given account of the performance of the obligations under the mandate contract.

(4) When the principal has concluded the prospective contract directly or another person appointed by the principal has concluded the prospective contract on the principal's behalf, the representative is entitled to the price or a proportionate part thereof if the conclusion of the prospective contract can be attributed in full or in part to the representative's performance of the obligations under the mandate contract.

(5) When the prospective contract is concluded after the mandate relationship has terminated, the principal must pay the price if payment of a price based solely on the conclusion of the prospective contract was agreed and:

- (a) the conclusion of the prospective contract can be attributed mainly to the representative's performance of the obligations under the mandate contract; and*
- (b) the prospective contract is concluded within a reasonable period after the mandate relationship has terminated.*

COMMENTS

A. General idea

This Article provides that a professional representative is normally entitled to a price for the services rendered, even if the parties neglected to explicitly regulate the matter. This does not apply however if it can be proved that the principal expected the contract to be gratuitous and that it was reasonable in the circumstances to think so. This provision further provides that, as a default rule, payment of the price is due only after the services of the representative have led to the conclusion of the prospective contract and the representative has so informed the principal.

Paragraph (3) regulates the payment of the price where the representative has not managed to conclude the prospective contract during the mandate relationship but the parties have agreed on a payment for services rendered. Such payment is due when the representative has given an account to the principal.

Paragraphs (4) and (5) concern the consequences as to the right to payment for the representative when, despite the efforts made by the representative in concluding the prospective contract, it is eventually concluded by the principal or another representative appointed by the principal. Under paragraph (4) the prospective contract is concluded during performance, whereas under paragraph (5) the prospective contract is concluded when the mandate relationship is no longer in force. Paragraph (4) indicates that the representative retains the right to be paid, whether fully or partially, if the conclusion of the prospective contract can be attributed in full or in part to the representative's performance of the obligations under the mandate contract. Under paragraph (5) the representative has to show that the contract was mainly the result of the representative's efforts. In addition, the contract must have been concluded within a reasonable period after the relationship is terminated.

B. Price for professional party

Traditionally, the mandate relationship is considered to be of a gratuitous nature. However, the gratuitous nature is in modern practice no longer self-evident. Especially where professional representatives are involved, the performance of the mandate – i.e. the service the representative provides – is nowadays normally for a price. This provision in the first half of paragraph (1) reflects the normal situation in practice: a representative who has entered the mandate contract in a professional capacity is entitled to payment, unless the parties have agreed otherwise.

C. Unless principal may reasonably expect no charge

Paragraph (1) also provides, however, an exception to the normal rule. No price will be payable if the principal expected the representative to perform the contract gratuitously and it was indeed reasonable to have such an expectation.

Illustration 1

A hotel (representative) advertises that a tour could be arranged without any indication as to the price for its service. A client (principal) thought it would be arranged for free (just as a service). Even though the hotel is acting in its professional capacity, it is rather common that these services are offered free of charge, unless the hotel explicitly mentions the opposite. Under these conditions, the hotel guest could reasonably expect that the hotel would be willing to perform this service gratuitously because it is interested in getting positive reports from guests or has hopes of being able to sell other (paid) services.

D. When price payable

Specific rule provided. Under III.–2:102 (Time of performance) paragraph (1) when the parties have not agreed differently, performance of an obligation, and therefore also payment by the principal, is due ‘within a reasonable time after the conclusion of the contract’. This does not give the parties much guidance in the case of a mandate relationship, which may, but not always does imply that the representative is to perform the obligations within a certain period of time. In fact, many mandate relationships are long-term contracts or their performance by the representative at least may take some time, if it is successful at all. This Article provides a specific rule as to the time of performance of the obligation of the principal to pay the representative. According to paragraph (2), the price becomes due only after the representative has performed successfully the main obligations under the mandate contract and has given account of that to the principal under IV.D.–3:402 (Giving account to principal) paragraph (1).

Price for services rendered agreed upon. In the case where the parties had agreed upon payment of a price for services rendered, the representative is also entitled to payment if the mandate relationship has terminated but the prospective contract is ultimately not concluded. In such a case, the representative has already rendered some services. In that case, paragraph (3) provides that the price is payable when the representative has given account of what has been done in the performance of the mandate contract under IV.D.–3:402 (Giving account to principal) paragraph (3).

Balance of interests. This solution is justified because it best satisfies the interests of both parties. It provides a good incentive for the representative to give account of the way the mandate has been carried out, as no payment will be due otherwise. Requiring the representative to give account first means that the principal is able to evaluate whether or not the representative has properly performed the obligations under the contract. Moreover, this rule has the benefit of establishing a moment when the price becomes due which is clear to both parties at that moment, as the parties have been in contact with each other. This rule therefore stimulates communication between the parties.

E. Price when prospective contract is not concluded by representative

Representative entitled to payment. Paragraph (4) deals with the question whether the representative is entitled to be paid if the prospective contract is concluded by the

principal personally or by another representative in contracts in which no exclusivity was granted to the representative. When the representative was not allowed exclusivity, payment should be due only for the services rendered. This provision contains an in-between solution according to which the representative is entitled to the price, or part thereof, if the services rendered have contributed to the conclusion of the prospective contract.

Illustration 2

A principal mandates a representative to sell the principal's car. The representative negotiates with a third party, but the third party refuses the offer made by the representative. The third party then contacts the principal directly and they conclude the sales contract. In this case, as the services of the representative have undoubtedly contributed to the conclusion of the sales contract, the representative would be entitled to the price (in full or in part).

No exclusivity granted. The situation which is described in paragraph (3) is to be differentiated from the situation in which the representative was awarded exclusivity but the principal nevertheless concluded the prospective contract personally or had it concluded by another representative. In such a case the principal is in breach of contract and is liable in damages. If that is the case, the representative would have to be put as nearly as possible into the position which would have prevailed if the principal had respected the exclusivity clause. This would imply that the principal would have to compensate the loss which the representative has suffered and the gain of which the representative has been deprived. In other words, the representative would receive the expectation interest.

F. Price if prospective contract is concluded after termination, but is mainly the result of the efforts of the representative

Representative entitled to payment. Paragraph (5) deals with the situation where a mandate relationship, in which the obligation to pay arises only on the conclusion of the prospective contract ("no result, no pay"), is terminated and subsequently the principal or somebody acting on the principal's behalf concludes the prospective contract. In this situation the representative retains the right to payment if the contract concluded was mainly the result of the representative's efforts in the performance of the mandate and if it is concluded within a reasonable time after the mandate relationship is terminated.

Balance of interests. In this type of contract, there is a substantial risk that the principal will try to evade the obligation to pay by terminating the mandate relationship just before the principal concludes the prospective contract. In order to protect the interests of the representative, the principal should therefore be required to pay the price even though the mandate relationship had already terminated. On the other hand, it does not seem fair to require the principal, under all circumstances, to pay the full price if the representative did not conclude the prospective contract after all. Therefore the obligation to pay remains only when certain conditions are fulfilled. This is therefore a balanced solution where the interests of both the representative and the principal are safeguarded.

Illustration 3

A principal mandates a representative to sell the principal's car. The representative negotiates with a third party and comes to an agreement, subject to approval by the principal. The principal does not give the approval, terminates the mandate relationship, and subsequently concludes the sales contract on (almost) the same terms with the third party.

Illustration 4

A principal mandates a representative to sell the principal's car. They agree on a mandate contract with a duration of 3 months. The representative negotiates with a third party and comes to an agreement, subject to approval by the principal. The principal waits until the 3 months period has ended and subsequently concludes the sales contract on (almost) the same terms with the third party.

In both cases it is clear that the principal has terminated the contractual relationship (Illustration 3) or waited for the fixed date to expire (Illustration 4) in order to prevent the representative from concluding the contract with the third party.

Illustration 5

A principal mandates a representative to sell the principal's car. The representative negotiates with a third party. The principal, not satisfied with the progress the representative makes, terminates the mandate relationship and appoints another representative. The new representative ends the negotiations successfully and concludes the sales contract.

In this case, the first representative's efforts have contributed to the conclusion of the prospective contract, but they did not mainly result in the conclusion of the contract with the third party: the services of the second representative were equally necessary. In this case, the representative is not entitled to payment of the price.

3. Similar to regime for commercial agency contracts. It should be noted that paragraph (4) is worded in a similar manner as IV.E.–3:302 (Commission after the agency has ended), where the commercial agent under certain conditions is entitled to commission for contracts concluded after the commercial agency contract has terminated.

IV.D.–2:103: Expenses incurred by representative

(1) When the representative is entitled to a price, the price is presumed to include the reimbursement of the expenses the representative has incurred in the performance of the obligations under the mandate contract.

(2) When the representative is not entitled to a price or when the parties have agreed that the expenses will be paid separately, the principal must reimburse the representative for

the expenses the representative has incurred in the performance of the obligations under the mandate contract, when and in so far as the representative acted reasonably when incurring the expenses.

(3) The representative is entitled to reimbursement of expenses under paragraph (2) as from the time when the expenses are incurred and the representative has given account of the expenses.

(4) If the mandate relationship has terminated and the prospective contract is not concluded, the representative is entitled to reimbursement of the expenses incurred in the performance of the obligations under the mandate contract. Paragraph (3) applies accordingly.

COMMENTS

A. General idea

In the traditional view of a mandate relationship as a gratuitous service, it is logical that expenses should be reimbursed. However, nowadays, mandate relationships are typically remunerated contracts. The present Article regulates the reimbursement by the principal of the expenses incurred by the representative in the performance of the obligations under remunerated mandate contracts. Paragraph (1) indicates that, as a general rule, the price agreed by the parties in mandate contracts includes the expenses that the representative has to incur in the performance of the mandate. In cases where the parties agree that the expenses are to be paid separately or where there is no price to be paid, paragraph (2) establishes that the principal has to pay only the reasonable expenses, i.e. in so far as the representative acted reasonably when incurring the expenses.

B. Expenses included in the agreed price

Typically, the parties make explicit contractual arrangements as to the reimbursement of the expenses. This provision regulates the situation where the contract is for a price and the parties remain silent about the matter of expenses. Paragraph (1) states that the principal – whether a consumer or a business – may reasonably rely on the price encompassing both the profit the representative seeks to gain from performing the contract and all the costs the representative will incur in carrying out the mandate.

If the default rule did not consider the expenses included in the price, the representative would have no incentive to perform as efficiently as possible, as higher expenses would automatically have to be reimbursed by the principal. If the representative wishes to have the expenses reimbursed separately, this ought to be made clear to the principal by a provision in the contract. The chosen default rule therefore also promotes communication between the parties.

C. Reasonable expenses only

If the expenses are not included in the price, i.e. when on the basis of an express contractual agreement the expenses are to be paid separately or when the mandate is gratuitous, the principal is required to reimburse the representative for the expenses

incurred, only if the representative acted reasonably when incurring the expenses (paragraph (2)).

D. When expenses payable

If and in so far as the representative is entitled to reimbursement of the expenses, the reimbursement only becomes due when the representative has given account of the performance of the mandate, as paragraph (3) of the Article expresses. The reasoning behind this is that the principal need only reimburse the representative for the expenses that were incurred reasonably, and the principal can only evaluate the reasonableness when the representative has provided the means of doing so. The present rule therefore has the advantage that the principal is given an effective instrument to obtain sufficient information in order to evaluate the reasonableness of the expenses incurred.

E. Expenses when no prospective contract concluded, no entitlement to price but to expenses

Where the mandate relationship is terminated before the prospective contract is concluded, the representative is left without payment, unless the parties had agreed upon payment for services rendered. In this respect, the representative is required to reach the envisaged result (the conclusion of the prospective contract) or lose the right to payment. This should, however, not mean that the representative then also has to bear the expenses incurred in carrying out the mandate. For that reason, paragraph (4) explicitly provides that the representative is entitled to recovery of the expenses. This provision also prevents an *a contrario* reasoning on the basis of paragraph (1) of the Article.

CHAPTER 3: PERFORMANCE BY THE REPRESENTATIVE

Section 1: Main obligations of representative

IV.D.–3:101: Obligation to act in accordance with mandate

Before and during the negotiations and in the conclusion of the prospective contract the representative must act in accordance with the mandate.

COMMENTS

A. General idea

The representative is performing a service for the principal. The service to be provided is determined by the authorisation and instruction of the principal, i.e. the mandate granted to the representative. The representative is hence required to act in accordance with such mandate. The principal determines how the representative is to perform the contractual obligations and what the contents of the prospective contract are.

B. Authorisation, instruction and subsequent directions

The mandate granted to the representative, which consists of the authorisation, initial instruction and any subsequent directions of the principal, provides the information pertaining to the performance of the mandate and to the contents of the prospective contract. This means that the representative undertakes the obligation to act in accordance with the power granted by the principal (authorisation) and with the guidelines given by the principal, both at the time the contract is concluded and subsequently during the performance (instruction and subsequent directions).

IV.D.–3:102: Obligation to act in interests of principal

(1) The representative must act in accordance with the interests of the principal, in so far as these have been communicated to the representative or the representative could reasonably be expected to be aware of them.

(2) The representative must request information from the principal as to the principal's interests which the representative is not aware of when such information is needed to allow the proper performance of the obligations under the mandate contract.

COMMENTS

A. General idea

The representative is authorised and instructed, i.e. mandated, by the principal to affect the principal's legal position. When the representative accepts the mandate granted by the principal, the representative undertakes the obligation to act in accordance with the mandate (IV.D.–3:101 (Obligation to act in accordance with mandate)) but also the obligation under the present Article to act in the interests of the principal. In order to do so, the representative will need to know the interests of the principal. This provision indicates that the representative must act in accordance with those interests of the principal of which the representative should be aware, either because these have been communicated by the principal or because the representative could be expected to know of them otherwise.

Illustration 1

A principal mandates a solicitor to appeal a court decision with which the principal fundamentally disagrees. In this case, the interests of the principal are sufficiently clear and no further information is needed for the solicitor to be able to perform the task.

Illustration 2

A principal authorises and instructs a representative to buy "a vintage car". As the representative does not have more information, it will be necessary to ask the principal what the maximum price is to be and whether there are specific types of

vintage cars, or cars of a specific period (e.g. the 1920s or 1950s) in which the principal is particularly interested.

B. Representative's obligation to obtain necessary information on the principal's interests

Most of the principal's interests are explicitly communicated to the representative. Other interests should be known to the representative because they could be inferred from the contract, the authority, the instructions, the subsequent directions of the principal and any other information regarding the mandate relationship. In some cases, however, the representative may have to require the principal to give indication as to interests of which the representative is unaware. The representative may be under an obligation to obtain the necessary information by asking the principal direct questions pertaining to the content of the prospective contract and the principal's preferences and priorities. For these reasons, the representative may be expected to actively obtain information from the principal in order to be able to properly carry out the mandate.

IV.D.–3:103: Obligation of skill and care

(1) The representative must perform the obligations under the mandate contract with the care and skill that the principal is entitled to expect under the circumstances.

(2) If the representative professes a higher standard of care and skill the representative must exercise that care and skill.

(3) If the representative is, or purports to be, a member of a group of professional representatives for which standards exist that have been set by a relevant authority or by that group itself, the representative must exercise the care and skill expressed in these standards.

(4) In determining the care and skill the principal is entitled to expect, regard is to be had, among other things, to:

(a) the nature, the magnitude, the frequency and the foreseeability of the risks involved in the performance of the obligations;

(b) whether the obligations are performed by a business;

(c) whether a price is payable and, if one is payable, its amount; and

(d) the time reasonably available for the performance of the obligations.

COMMENTS

A. General idea

This Article sets out general criteria to determine the standard of skill and care expected of a representative. It is similar in content to IV.C.–2:105 (Obligation of skill and care) for service contracts.

B. Determination of standard of care for representatives

The representative does not guarantee that the prospective contract will be concluded: the obligation is only needs to perform in accordance with the skill and care that the principal is entitled to expect. Paragraph (4) provides an indicative list of factors to be taken into account in determining the standard of skill and care that the principal is entitled to expect from the representative.

C. Specific standard of care

Paragraphs (2) and (3) deal with situations in which the representative is obliged, in view of the specific circumstances, to observe a specific standard of skill and care. Paragraph (3) refers to the case in which the representative professes a higher standard of skill and care, whilst paragraph (4) refers to the standard of skill and care expected of representatives who belong to a certain group of professional representatives. Obviously, the standard of skill and care that may be expected from a representative falling under paragraphs (2) or (3) will also have to be measured against the criteria set out under paragraph (4), taking into account the (purported) higher expertise of such a representative.

Section 2: Consequences of acting beyond mandate

IV.D.–3:201: Acting beyond mandate

- (1) The representative may act in a way not covered by the mandate if:*
- (a) the representative has reasonable ground for so acting on behalf of the principal; and*
 - (b) the representative does not have a reasonable opportunity to discover the principal's wishes in the particular circumstances; and*
 - (c) the representative does not know and could not reasonably be expected to know that the act in the particular circumstances is against the principal's wishes.*
- (2) As between the representative and the principal an act within paragraph (1) is regarded as being covered by the mandate.*
- (3) In relation to third parties the consequences of an act within paragraph (1) are governed by Book III, Chapter 6 (Representation).*

COMMENTS

A. General introduction to Section

This Section does not deal with the *external* consequences of the fact that the representative has acted beyond the mandate. Whether or not a contract with a third party has been concluded by the representative by acting beyond the mandate, is determined by Book II, Chapter 6 (Representation). Nor does it deal with the question whether the

principal may avoid being bound to the prospective contract by a timely limitation or revocation of the authority of the representative. That, too, is governed by Book II, Chapter 6 (Representation). This Section deals only with the internal consequences of an acting by the representative beyond the scope of the mandate. Where the representative does so act, the prospective contract with the third party may or may not be valid, as there may have been (apparent) authority under Book II, Chapter 6 (Representation). In the *internal* relationship between the representative and the principal, however, the fact that the representative has acted beyond the mandate will normally imply that the representative has failed to perform the contractual obligations towards the principal and will therefore be liable for the non-performance, unless this Section provides otherwise.

B. General idea of Article

Under the present Article, the representative must act in accordance with the mandate, i.e. the authorisation and instruction given by the principal. If the representative acts outside the boundaries determined by the principal, then the representative is liable for non-performance of the contractual obligations. Hence, in the event of new developments the representative is required to contact the principal and ask for guidance. However, there may be situations in which the representative has to take immediate action in order to safeguard the interests of the principal but has no time to contact the principal. In such a case, the representative is *allowed* to act beyond the mandate if certain requirements are met. This is the situation regulated in the present Article.

C. Conditions for acting beyond mandate

Paragraph (1) provides that the representative may act beyond the mandate (without incurring liability for so doing) only when certain cumulative requirements are met. These requirements are meant to limit the representative's discretion to act beyond mandate to those situations where no reasonable principal could be expected not to agree to grant permission, taking into account all the circumstances that the representative is aware of or could reasonably be expected to be aware of, including the principal's expressed or implied interests.

First, the representative needs to have a reasonable ground for acting beyond the mandate, that is, can only do so if this is necessary to safeguard the principal's interests, e.g. if it is necessary to accept an offer which expires before the representative is able to contact the principal. Secondly, the representative must not have a reasonable opportunity to discover the principal's wishes in the particular circumstances. Finally the representative must not know (or be in a situation where such knowledge could reasonably be expected) that the act in the particular circumstances is against the principal's wishes.

D. Relation to benevolent intervention

The present Article starts from the idea that if the representative complies with the criteria which would allow action to be taken as a benevolent intervener - in which no contractual relationship exists - under the rules of V.-3:106 (Authority of intervener to act as representative of the principal), then the representative is also deemed to be in a

situation in which act beyond the mandate is permissible. Accordingly the conditions that the representative has to met in order to be able to act beyond the mandate are basically the same as are required under Book V to act as a benevolent intervener (see V.–1:101 (Intervention to benefit another)). These are as follows. (a) The benevolent intervener has reasonable ground for acting on behalf of the principal. (b) The benevolent intervener does not have a reasonable opportunity to discover the principal's wishes. (c). The benevolent intervener does not know and could not to know that the intervention is against the principal's wishes. If these requirements are met, under V.–3:106 (Authority of intervener to act as representative of the principal) the benevolent intervener may conclude a contract or otherwise affect the legal relations of the principal.

Obviously, the third requirement will cause some difficulty when applied to mandate relationships, as the principal may argue that the representative ought to have known that the intervention is against the principal's wishes, as the mandate granted to the representative itself indicates that the principal does not want the representative to go any further. However, this may not always be true. Especially when unforeseen circumstances manifest themselves, a situation may arise which the parties had not taken into consideration when the power was granted. In such a situation, the representative may need to exceed the mandate in order to achieve the result as indicated in the mandate contract.

E. Obligation to act beyond mandate not regulated

The question whether or not the representative may be *required* to act beyond mandate is not regulated in this Article. Whether or not that is the case, must be determined from IV.D.–3:102 (Obligation to act in interests of principal) and IV.D.–3:103 (Obligation of skill and care).

IV.D.–3:202: Consequences of ratification

Where, in circumstances not covered by the preceding Article, the representative has acted beyond the mandate in concluding the prospective contract on behalf of the principal, ratification of that contract by the principal absolves the representative from liability to the principal, unless the principal without undue delay after ratification notifies the representative that the principal reserves remedies for the non-performance by the representative.

COMMENTS

A. General idea

Under the preceding Article, the representative may under strict conditions act beyond the mandate. Where not allowed to do so, the representative may be liable for non-performance of the contractual obligations.

This provision regulates the consequences as to the liability of a representative who acts beyond the mandate if the principal subsequently ratifies the contract concluded by the representative. The ratification by the principal implies that the liability of the representative for having acted beyond mandate is excluded. If the principal nevertheless wants to retain the right to exercise remedies for non-performance, this must be explicitly indicated without undue delay.

B. Conditions for acting beyond mandate not met

If the representative acts beyond the mandate in circumstances not covered by the preceding Article it may still be the case that the principal is prepared to accept the contract so concluded.

Illustration 1

A principal asks a representative to purchase from the principal's regular supplier of cheese and tomatoes 1000 kilos of cheese for a price of €750. The principal intends to use the cheese in the production of pizzas. The representative informs the supplier of these instructions. The supplier then tells the representative of a special offer available for tomatoes. The representative knows that this would normally be considered a very good deal and buys a quantity of tomatoes. To keep relations with the regular supplier smooth, the principal ratifies the contract with the supplier, even though the principal intended to buy the tomatoes from another supplier at an even lower price.

In this Article, it is assumed that the ratification does indeed indicate that the principal tolerates the representative's actions – in which case the principal would not be interested in a possible claim against the representative for acting beyond the mandate – but it is left to the principal to indicate otherwise.

C. Retention of remedies

If the principal ratifies the prospective contract even though the representative acted beyond the mandate, the liability of the representative is, in principle, excluded. In order not to burden the representative with too much uncertainty, the principal would have to notify the representative without undue delay of an intention to retain remedies for non-performance.

Section 3: Conclusion of prospective contract by other person

IV.D.–3:301: Exclusivity not presumed

The principal is free to conclude the prospective contract directly or to appoint another representative to conclude it.

COMMENTS

A. General idea

The present Article starts from the presumption that the principal remains free, despite the mandate contract with a representative, to conclude the prospective contract personally or to appoint another representative to conclude it. The parties may, however, agree otherwise by awarding the representative exclusivity.

B. Conclusion of prospective contract by principal or by another representative in case of irrevocable mandate

According to IV.D.–7:101 (Conclusion of the prospective contract), the conclusion of the prospective contract by the principal or another representative appointed by the principal will terminate the mandate relationship if the mandate was solely for the conclusion of a specific contract. That will have the effect of a revocation of the mandate (IV.D.–1:104 (Revocation of the mandate) paragraph (2) In the case where the representative is awarded an irrevocable mandate, this usually implies that the representative is also awarded exclusivity. This then implies that the principal may no longer conclude the prospective contract personally or by means of another representative.

This may, however, not always be the case.

Illustration 1

The successors of the former owner of a car decide that the car is to be sold for a good price. They mandate two of them to execute their decision independently of each other, agreeing that the car is to be sold for a price of more than €10,000 and that the first who sells the car accordingly receives payment of 1% of the sale price, whereas the other will not be rewarded. As one of the successors has a fickle nature and might all of a sudden change his mind, the successors decide to make both mandates irrevocable. In this case, the irrevocability is not combined with exclusivity.

It is therefore necessary to determine whether the parties to the underlying legal relationship, when agreeing on an irrevocable mandate, have intended to grant the representative exclusivity. However, this will normally be the case.

IV.D.–3:302: Subcontracting

(1) The representative may subcontract the performance of the obligations under the mandate contract in whole or in part without the principal's consent, unless personal performance is required by the contract.

(2) Any subcontractor so engaged by the representative must be of adequate competence.

(3) In accordance with III.–2:106 (Performance entrusted to another) the representative remains responsible for performance.

COMMENTS

General idea

In principle, the representative may entrust the performance of the representative's obligations under the mandate contract to a third party. This Article particularises the rule in III.–2:107 (Performance by a third person), which makes performance by a third party possible unless the contract requires personal performance. When a third party is involved in the performance of the contract, the party that entrusts the performance to this third party is still responsible for the performance under III.–2:106 (Performance entrusted to another). The rules of the present Article do not change this; they merely add an obligation for the representative - to select adequately the subcontractors involved in the performance of the service. The Article is in conformity with the corresponding provisions in the Book on Service Contracts, IV.C.–2:104 (Subcontractors, tools and materials) paragraphs (1) and (2).

Section 4: Obligation to inform principal

IV.D.–3:401: Information about progress of performance

During the performance of the obligations under the mandate contract the representative must in so far as is reasonable under the circumstances inform the principal of the existence of and the progress in the negotiations leading to the possible conclusion of the prospective contract.

COMMENTS

A. General idea

During performance of the obligations under the mandate contract the representative must keep the principal informed about the performance. This Article opts to impose on the representative – who is aware of all relevant information and who may be in need of sufficiently detailed instructions – the obligation to actively keep the principal informed rather than requiring the principal – who may not know what to ask or what information the representative would be in need of – to ask for information.

B. Volunteer information in so far as is reasonable under the circumstances

An obligation for the representative to keep the principal informed all the time would be unreasonably burdensome for the representative. It is simply not feasible to keep the principal informed about every detail of the representative's actions. Moreover, an

obligation which would be too far-reaching could even be counterproductive as the principal might be inclined to intervene with the details of the representative's services and thus slow down the actual conclusion of the prospective contract (and the emergence of the representative's right to payment). Accordingly, in the text of the present Article, the obligation of the representative is limited by the requirement of 'reasonableness'. The representative is under an obligation to volunteer the information which would allow the principal to be in a better position to give directions as to the performance of the mandate. This would enhance the chances that the content of the prospective contract is in accordance with the true needs of the principal.

IV.D.-3:402: Giving account to principal

(1) The representative must without undue delay inform the principal of the conclusion of the prospective contract.

(2) The representative must give an account to the principal:

(a) of the manner in which the obligations under the mandate contract have been performed; and

(b) of money spent or received or expenses incurred by the representative in performing the obligations under the mandate contract.

(3) Paragraph (2) applies with appropriate adaptations if the mandate relationship is terminated in accordance with Chapters 6 and 7 and the prospective contract has not been concluded.

COMMENTS

A. General idea

The representative is required to notify the conclusion of the prospective contract – and therefore the completion of the tasks under the mandate contract – to the principal and to give account of the manner in which contractual obligations have been performed. This information is meant, first of all, to enable the principal to assess whether or not the obligations were performed properly (i.e. in accordance with the mandate, in the interests of the principal and with the due standard of care). On the other hand, the representative also has an interest in performing the obligations under this Article, as their performance is a prerequisite for payment of the price (IV.D.-2:102 (Price) paragraphs (2) and (3)) or reimbursement of expenses (IV.D.-2:103 (Expenses incurred by representative) paragraph (3)).

B. Without undue delay

The representative must inform the principal without undue delay of the conclusion of the prospective contract. This is important especially in cases where the representative is not awarded exclusivity and the principal could also conclude the prospective contract personally.

Illustration 1

A principal has commissioned a representative with the sale of her pied-à-terre for a price of €200,000. She has informed the representative of the fact that she is aware of the interest of neighbours in the purchase of the house and that she may decide to sell them the house herself. The representative, who realises that the house is in popular demand and that it will be necessary to work fast in order to obtain a price for services rendered, succeeds in selling the house after two days of work only. If the representative does not report this success without undue delay, there is a substantial risk that the principal will sell the house herself as well. In that case, the house would be sold twice, leading to liability for the principal for non-performance of obligations under either the first or the second sales contract.

C. Giving account if mandate relationship is terminated and prospective contract has not been concluded

The obligation to give account on how the obligations were performed is particularly relevant if the representative has not been successful in concluding the prospective contract; in such cases the representative may not volunteer information as to the manner in which the obligations were performed because the representative is not going to receive payment in any case. The termination (for any reason) of the mandate relationship in cases where the representative has not been successful in concluding the prospective contract does not exclude the obligation to give account to the principal on the manner in which the obligations under the mandate contract have been performed and the money spent or received or expenses incurred by the representative in performing those obligations.

D. Giving account during mandate relationship

It is certainly not in the interest of either party that the representative is required to inform the principal of every step taken in the performance of the obligations under the mandate contract. Such a general obligation would, in fact, make the performance unreasonably burdensome for the representative without any substantial gain for the principal. It may, however, be different in the situation where the parties had anticipated that the prospective contract would be concluded, for instance when negotiations appeared to be leading to the conclusion of such a prospective contract. Under these circumstances, it may follow from IV.D.–3:102 (Obligation to act in interests of principal) and IV.D.–3:103 (Obligation of skill and care) that the representative is required to inform the principal promptly about the collapse of these negotiations. Similarly, it may follow from these Articles that the representative is required to inform the principal of the (lack of) progress in the performance of the obligations under the mandate contract when the principal inquires about this progress and such a request for information could be considered reasonable.

IV.D.–3:403: Communication of identity of third party

(1) The representative must communicate the name and address of the third party to the principal on the principal's demand.

(2) Paragraph (1) does not apply in the case of a mandate for indirect representation.

COMMENTS

A. General idea

The present Article obliges the representative, on the principal's demand, to communicate the name and address of the third party to the principal in a situation where the principal is not aware of that name but is in need of knowing the name in order to exercise rights against the third party. This is one of those obligations which is intended to survive the termination of the mandate relationship as it may often fall to be performed some time after the prospective contract has been concluded.

Illustration 1

A representative buys a car from a third party in the name and on behalf of the principal. As the car is defective, the principal wishes to exercise her remedies under the sales contract. The representative is required to inform the principal of the name and address of the seller of the car.

B. No obligation to communicate name and address in case of indirect representation

In the case of indirect representation – a situation where the representative has acted on behalf of the principal but in the representative's own name – no contractual ties exist between the principal and the third party.

Illustration 2

A representative has bought a car from a third party in the representative's own name but on behalf of the principal. As the car is defective, the principal wishes to exercise her remedies under the sale contract. As she does not have a sale contract with the seller of the car but only a mandate contract with the representative, she will have to exercise her remedies against the representative. It is up to the representative to subsequently sue the seller of the defective car on the basis of the sale contract.

CHAPTER 4: DIRECTIONS AND CHANGES

Section 1 : Directions

IV.D.–4:101: Directions given by principal

- (1) The principal is entitled to give directions to the representative.*
- (2) The representative must follow directions by the principal.*
- (3) The representative must warn the principal if a direction:*
 - (a) has the effect that the conclusion of the prospective contract would become significantly more expensive or take significantly more time than agreed upon in the mandate contract; or*
 - (b) is inconsistent with the purpose of the mandate contract or may otherwise be detrimental to the interests of the principal.*
- (4) Unless the principal revokes the direction without undue delay after having been so warned by the representative, the direction is to be regarded as a change of the mandate contract under IV.D.–4:201 (Changes of the mandate contract).*

COMMENTS

A. General idea

This Article indicates that the principal is the ‘master of the contract’: the representative is required to follow directions given by the principal after the contract is concluded, even if the representative disagrees with them (paragraph (2)). However, where the representative thinks that the direction is detrimental to the interests of the principal, the must warn the principal accordingly (paragraph (3)). Paragraph (4) requires the representative to wait to see whether the principal, after having been warned that the given direction may be detrimental, wants to revoke it. If the principal nevertheless holds the representative to the direction, there is a change in the mandate contract – a matter regulated in IV.D.–4:201 (Changes of the mandate contract).

B. Principal’s right to give subsequent directions

The mandate of the representative consists of the authorisation, initial instructions and subsequent directions of the principal, i.e. the decisions of the principal given during the mandate relationship as to the performance of the obligations under the mandate contract or the contents of the prospective contract (see IV.D.–1:102 (Definitions)). The principal is therefore entitled to give subsequent directions (paragraph (1)).

The right of the principal to provide directions voluntarily is to be differentiated from the situation in which the principal has an obligation to give directions under IV.D.–2:101 (Obligation to co-operate) paragraph (2)(b). This obligation arises when the contract so

provides, or when the principal is requested by the representative to give a direction (IV.D.–4:102 (Request for a direction)).

C. Representative’s obligation to follow subsequent directions

The representative is obliged to act in accordance with the mandate granted (IV.D.–3:101 (Obligation to act in accordance with mandate)). The mandate of the representative consists of the initial authorisation and instructions and any subsequent directions. Accordingly, the representative is obliged to follow the subsequent directions of the principal.

D. Obligation to warn in case of unreasonable direction

Paragraph (3) has the effect of imposing on the representative an obligation to warn the principal if a direction is unreasonable. “Unreasonable” is here a shorthand way of referring to directions perceived by the representative to be contrary to the interests of the principal – in particular those which have the effect that the conclusion of the prospective contract would become significantly more expensive or take significantly more time than agreed upon in the mandate contract or those which are inconsistent with the purpose of the mandate contract or may otherwise be detrimental to the interests of the principal (paragraph (3)(a) and (b) respectively).

Illustration 1

If a representative is first authorised to sell a house owned by the principal for a price of €400,000 or more, but the principal later changes the limit to €450,000, which is above the market price, it will take the representative more time to sell the house and there is a serious risk that it will not be possible to conclude the prospective contract.

E. Upholding an unreasonable direction leads to change in the contract

If the principal, on being warned that a direction is unreasonable, does not revoke it within a reasonable time, then it is to be considered a change to the mandate contract. The consequences of such a change are regulated in IV.D.–4:201 (Changes of the mandate contract).

F. Warning excludes liability of the representative

Whether the direction in fact makes it more difficult to achieve the result envisaged by the principal or not is not the representative’s concern, as long as the representative warns the principal of this possible consequence of a direction perceived not to be in the interest of the principal. Obviously, a representative who has duly warned the principal of the consequences of following the direction cannot be held liable for non-performance if the end result does not meet the principal’s expectations: that merely shows that the representative was correct in the warning. It would be different only when the representative, on the basis of the obligation to exercise due skill and care, could be required in the given circumstances to terminate the mandate relationship.

IV.D.-4:102: Request for a direction

(1) The representative must ask for a direction on obtaining information which requires the principal to make a decision pertaining to the performance of the obligations under the mandate contract or the content of the prospective contract.

(2) The representative must ask for a direction if the mandate contract does not determine whether the mandate is for direct representation or indirect representation.

COMMENTS

A. General idea

Under this Article the representative is obliged to ask for directions from the principal in two main situations: (1) when the representative needs a decision of the principal pertaining to the performance of the obligations under the mandate contract or the content of the prospective contract and (2) when the representative needs the direction of the principal as to whether the mandate is for direct or indirect representation.

B. Direction as to performance of obligations or as to contents of prospective contract

The situation regulated here is where the representative has received information (either from the principal or from another source), which indicates that it may not be possible to conclude the prospective contract as stated or envisaged by the principal at the time of conclusion of the contract, or that the conclusion of the prospective contract may become significantly more expensive or take significantly more time than agreed upon in the mandate contract. The same would of course apply if the conclusion of the prospective contract could damage other interests of the principal of which the representative knows or could reasonably be expected to know. In this respect, it would not matter whether the danger stems from a defect or inconsistency in the mandate of the representative (be it in the mandate contract itself or a subsequent direction) or from the occurrence of other expected or unexpected events. One such event could be the development of the negotiations with the third party. It can easily be envisaged that during such negotiations the representative may realise that in order to conclude the prospective contract, it would be necessary to act beyond the mandate. Where there is time to contact the principal, the representative is required to do so in order not to breach the contractual obligations, as on the one hand the representative may not exceed the mandate, but on the other hand is required to act in the best interests of the principal. Paragraph (1) of this Article indicates what the representative then has to do: ask for a direction. The principal subsequently is required to give such a direction under IV.D.-2:101 (Obligation to co-operate) paragraph (2)(b).

C. Representative to act in own name or in principal's name

Typically the parties to a mandate contract indicate expressly or implicitly whether the representative is to act in the representative's own name or in the name of the principal or

in either as the representative sees fit. If that is the case, the representative will be required to act in such manner, as follows from IV.D.-3:101 (Obligation to act in accordance with mandate). It should be remarked that even if the parties have not expressly indicated how the representative is to act, this may follow from custom or usage. In such a case, the parties will have implicitly chosen to follow the rules dictated by custom or usage.

The present Article clearly indicates that it is the principal who decides how to be represented, i.e. by way of direct or indirect representation. The principal may indicate that when the mandate contract is concluded or afterwards by way of a direction, cf. IV.D.-4:101 (Directions given by principal) paragraph (1). When the principal does not (expressly or tacitly) indicate how the representative is to act, the representative must ask for clarification on this point (paragraph (2)).

IV.D.-4:103: Consequences of failure to give a direction

(1) If the principal fails to give a direction when required to do so under the mandate contract or under paragraph (1) of the preceding Article, the representative may, in so far as relevant, resort to any of the remedies under Book III, Chapter 3 (Remedies for Non-Performance); or

(a) base performance upon the expectations, preferences and priorities the principal may reasonably be expected to have, given the information and directions that have been gathered; and

(b) claim a proportionate adjustment of the price and of the time allowed or required for the conclusion of the prospective contract.

(2) If the principal fails to give a direction under paragraph (2) of the preceding Article, the representative may choose direct representation or indirect representation or may withhold performance under III.-3:401 (Right to withhold performance of reciprocal obligation).

(3) The adjusted price that is to be paid under paragraph (1)(b) must be reasonable and is to be determined using the same methods of calculation as were used to establish the original price for the conclusion of the prospective contract.

COMMENTS

A. General idea

This provision sets out the consequences if the principal does not give a direction, even though required to do so under the contract or if the representative asks for a direction under IV.D.-4:102 (Request for a direction).

The Article proposes different systems of remedies depending on the situation. The remedy for not giving a direction as to the question whether the representative is to act in

the representative's own name or in the name of the principal (IV.D.–4:102 (Request for a direction) paragraph (2)), is given in paragraph (2) of the present Article: the representative is free to choose how to act. The representative may also withhold performance.

B. Choice of remedies

As regards the remedies for the non-performance by the principal of the obligation to give directions when the representative is in need of such directions in order to continue performance, two possible set of remedies can be chosen, as stated in paragraph (1). On the one hand the representative may invoke the application of the general remedies for non-performance of an obligation. On the other hand, if the representative chooses to continue performance, there is a right to adapt performance to the expectations, preferences and priorities the principal may reasonably be expected to have, given the information and directions that have been gathered, and claim a proportionate adjustment of the price and of the time allowed or required for the conclusion of the prospective contract.

Illustration 1

A principal instructs a representative to negotiate the purchase of a certain sculpture, without indicating clearly a maximum price for the sculpture. The parties agreed that the representative would have two weeks for performing the task. After one week, the representative has found a third party, the owner of the sculpture, willing to sell it for €10,000. The representative informs the principal of this and asks what answer is to be given to the third party. The principal however remains silent for another week.

Under the present Article the representative may claim damages if, as a result of the delay in the principal answering the request for a direction, the contract can no longer be concluded (Book III, Chapter III, Section 7). The representative may also terminate the mandate relationship for non-performance in so far as the non-performance of the obligation to give the direction amounts to a fundamental non-performance under III.–3:502 (Termination for fundamental non-performance)). The representative may also assume that the principal agrees to the purchase price if a this could reasonably be expected in the circumstances of the case, taking into account the express and implied wishes of the principal as these may be known to the representative (paragraph (1)(a)). The representative may claim extra time for performance of the mandate (paragraph (1)(b)). If the price has to be renegotiated because of the principal's failure to give a direction , the representative may claim extra remuneration (paragraph (1)(b)).

IV.D.–4:104: No time to ask or wait for direction

(1) If the representative is required to ask for a direction under IV.D.–4:102 (Request for a direction) but needs to act before being able to contact the principal and to ask for a direction, or needs to act before the direction is given, the representative may base

performance upon the expectations, preferences and priorities the principal may reasonably be expected to have, given the information and directions that have been gathered.

(2) In the situation referred to in paragraph (1), the representative may claim a proportionate adjustment of the price and of the time allowed or required for the conclusion of the prospective contract in so far as such an adjustment is reasonable given the circumstances of the case.

COMMENTS

A. General idea

This Article deals with the situation where immediate action is required by the representative in order to prevent detrimental consequences for the principal. The situation is so urgent that the representative has no time to ask or wait for a direction from the principal. If such is the case, the representative is entitled under this Article to continue performing on the basis of the expectations, preferences and priorities the principal may reasonably be expected to have, given the information and directions that have been gathered. The representative may subsequently claim a proportionate adjustment of the price and of the time allowed or required for the conclusion of the prospective contract in so far as such an adjustment is reasonable given the circumstances of the case.

In the situation in which the principal does not indicate whether the representation is to be direct or indirect and the representative does not have time to ask for clarification on this point, then the representative may determine whether to act in the representative's own name or in the name of the principal.

B. Relation to rule on acting beyond mandate

In the situations covered by this Article, the representative may have to act beyond the mandate. As indicated under IV.D.–3:201 (Acting beyond mandate), the representative is only allowed to act beyond mandate when certain conditions, enumerated in that Article, are fulfilled. The conditions would be satisfied in the circumstances envisaged by the present Article.

Section 2: Changes of the mandate contract

IV.D.–4:201: Changes of the mandate contract

(1) The mandate contract is changed if the principal:

(a) significantly changes the mandate of the representative; or

(b) does not revoke a direction without undue delay after having been warned in accordance with paragraph (3) of IV.D.–4:101 (Directions given by principal).

(2) In the case of a change of the mandate contract under paragraph (1) the representative may claim:

(a) a proportionate adjustment of the price and of the time allowed or required for the conclusion of the prospective contract; or

(b) damages in accordance with III.–3:702 (General measure of damages) to put the representative as nearly as possible into the position in which the representative would have been if the mandate contract had not been changed.

(3) In the case of a change of the mandate contract under paragraph (1) the representative may also terminate the mandate relationship by giving notice of termination for extraordinary and serious reason under IV.D.–6:105 (Termination by representative for extraordinary and serious reason), unless the change is minor or it enlarges the possibilities for the representative to conclude the prospective contract.

(4) The adjusted price that is to be paid under paragraph (2)(a) must be reasonable and is to be determined using the same methods of calculation as were used to establish the original price for the conclusion of the prospective contract.

COMMENTS

A. General idea

The obligations under a mandate contract are not performed instantaneously. The relationship remains in force for a period of time, definite or indefinite. For that reason, the principal must be allowed to give subsequent directions as to the performance of the obligations or the contents of the prospective contract. By doing so the principal may change the content of the mandate contract. According to this provision there is a change to the mandate contract when the principal significantly changes the mandate of the representative or when the principal does not revoke a direction without undue delay after having been warned that the direction was unreasonable. Under these conditions, the actions (or, as regards the revocation of the direction, the lack of action) of the principal may be seen as a material change of the contract. Under the present Article, such a change comes about automatically, but it does have important consequences. The present Article sets out what these consequences are.

B. Significant change in mandate

A change to the contract occurs when the principal extends or limits the mandate of the representative in a significant way.

Illustration 1

A representative is authorised to sell a house for no less than €400,000. The principal subsequently orders the representative to sell the house for at least €350,000. As a consequence of this direction, the representative's mandate is extended. Similarly, if the principal for the future tells the representative to sell

the house only for at least €450,000, the mandate of the representative is limited. In both cases, the mandate contract is changed under paragraph (1), which in accordance with paragraph (2) may have consequences for the price and the time for performance.

C. No revocation of unreasonable direction

A change of the contract also occurs where the principal refuses to revoke without undue delay a direction which the representative has warned will have the effect that the conclusion of the prospective contract would become significantly more expensive or take significantly more time than agreed upon in the mandate contract, or where the principal refuses to revoke a direction which the representative has warned is inconsistent with the purpose of the mandate contract or may otherwise be detrimental to the interests of the principal.

Illustration 2

If a representative is first authorised to sell a house owned by the principal for a price of €400,000, but the principal later authorises the representative to sell the house only for €450,000, which is above the market price, it will take the representative more time to sell the house and there is a serious risk that it will not be possible to conclude the prospective contract. If the principal, after having been warned of this by the representative, nevertheless holds the representative to the 'unreasonable' direction, this is regarded as a change of the mandate contract.

D. Proportionate adjustment of price and time of performance or damages

When the mandate contract is concluded, both parties have agreed upon a service to be performed in exchange (usually) for a price. The price and the time for performance have been based upon the cost, time and effort that performance will require from the representative. Therefore, an increase in the content and magnitude of the representative's obligations cannot be without effect on the time the representative has for the performance of the contract and the price which ought to be payable when the prospective contract is concluded. Consequently, paragraph (2)(a) entitles the representative to claim extra time for performance and an adjustment of the price. Under paragraph (2)(b) the representative could instead choose to claim damages to put the representative as nearly as possible into the position in which the representative would have been if the mandate contract had not been changed.

Especially when the change consists of a limitation of the initial mandate, the representative's interests may be endangered in a different way. The following Illustration may clarify this.

Illustration 3

A principal mandates an estate agent to sell the principal's house for no less than €250,000. The representative negotiates with a third party, a well-to-do artist, who seems willing to pay the requested sum. The principal, however, subsequently

limits the representative's power by requiring the representative to negotiate a sales contract for the price of €200,000 with a fourth party, who is less wealthy than the third party with whom the representative was negotiating, but with whom the principal has a personal relation.

The limitation of the mandate awarded to the representative may make it more difficult to conclude a contract, as the only possible candidate is now the third party indicated by the principal. This may require a change of the price for the service. Moreover, if the contract is indeed concluded with the fourth party, the sales price will be lower than was originally envisaged. In the case of contracts of this type, it is not unusual that the price for the services of the representative will be proportionate to the sale price. The limitation of the mandate will therefore directly affect the remuneration to be paid by the principal. In a situation such as this, damages may be a more suitable solution. As the change of the contract cannot be seen as the non-performance of an obligation by the principal since the principal is entitled to limit the power of the representative, an express provision entitling the representative to damages is required here.

E. Termination for extraordinary and serious reason

Where the principal severely limits the mandate but does not completely revoke it, this is to be regarded as a change of the mandate contract under the present Article. However, the change may give the representative reason to believe that it will not be possible to conclude the prospective contract. If that is the case, the representative has a good reason to fear that the services provided will be to no avail. As the entitlement to a price only comes into being when the prospective contract is concluded, the representative then has an extraordinary and serious reason to terminate the mandate relationship. Paragraph (3), in combination with IV.D.–6:105 (Termination by representative for extraordinary and serious reason) gives such a right. As a result, the difference between the situation where the mandate is revoked (leading to the automatic termination of the mandate relationship) and that where it is limited, is not as big as it may seem at first glance.

F. No entitlement to termination if minor change

Whereas it seems justified to allow the representative to terminate the mandate relationship for extraordinary and serious reason if the mandate is significantly changed, this is not the case where the change is minor. Nor is there any justification for allowing termination when the change actually *improves* the chances of the representative to conclude the prospective contract. This is the case when the mandate of the representative is extended. In such a case, the representative should not be able to escape from the mandate contract for the mere reason that the content of the mandate contract has changed. Paragraph (3) therefore provides that the change of the mandate contract in these cases does not constitute an extraordinary and serious reason for termination.

CHAPTER 5: CONFLICT OF INTEREST

IV.D.-5:101: Self-contracting

- (1) The representative may not become the principal's counterparty to the prospective contract.*
- (2) The representative may nevertheless become the counterparty if:*
 - (a) this is agreed by the parties in the mandate contract;*
 - (b) the representative has disclosed an intention to become the counterparty and*
 - (i) the principal subsequently expresses consent; or*
 - (ii) the principal does not object to the representative becoming the counterparty after having been requested to indicate consent or a refusal of consent;*
 - (c) the principal otherwise knew, or could reasonably be expected to have known, of the representative becoming the counterparty and the principal did not object within a reasonable time; or*
 - (d) the content of the prospective contract is so precisely determined in the mandate contract that there is no risk that the interests of the principal may be disregarded.*
- (3) If the principal is a consumer, the representative may only become the counterparty if:*
 - (a) the representative has disclosed that information and the principal has given express consent to the representative becoming the counterparty to the particular prospective contract; or*
 - (b) the content of the prospective contract is so precisely determined in the mandate contract that there is no risk that the interests of the principal may be disregarded.*
- (4) The parties may not, to the detriment of the principal, exclude the application of paragraph (3) or derogate from or vary its effects.*
- (5) If the representative has become the counterparty, the representative is not entitled to a price for services rendered as a representative.*

COMMENTS

A. General idea

The present Article starts from the same idea as II.-6:109 (Conflict of interest): the presumption that there is a conflict of interests when the representative concludes a contract with himself or herself in a personal capacity. The representative is therefore not allowed to do so. The main differences between the Articles are not of a substantive nature, but follow from their different focus: whereas II.-6.109 (Conflict of interest) deals with the *external* relationship between the principal and the third party, the present Article deals with the *internal* relationship.

Where the representative was not allowed to act as the third party, but has nonetheless done so, the act is not in conformity with the best interests of the principal and the representative is therefore liable for non-performance. However, there are situations

where this may be different. Paragraph (2) deals with this matter. For consumers, a more restrictive approach is taken in paragraph (3). This more restrictive rule is mandatory to protect the consumer's interest (paragraph (4)). Paragraph (5) deals with the consequences as regards the payment of the price.

B. Main rule: representative may not act as third party

One of the main obligations of the representative is to act in accordance with the interests of the principal (IV.D.-3:102 (Obligation to act in interests of principal)). In the situation in which the representative is at the same time the third party to the prospective contract (a situation also known as 'self-contracting'), a conflict of interests may arise.

Illustration 1

A principal mandates a representative to sell a precious Ming vase. The representative is himself interested in the purchase of the vase. Whereas the representative, as a buyer, will want to pay as little as possible, in his function as the representative of the principal, he is required to achieve as high a sale price as possible. These interests clearly collide.

An exception to the main rule is however possible when a conflict of interest is deemed or may be assumed not to exist. These cases are regulated in paragraph (2).

C. Self-contracting if agreed in mandate contract

A first exception to the ban on self-contracting is the situation where the contract itself indicates that the representative is entitled to act as the third party. Consent may be express or implied.

D. Self-contracting if representative discloses intention to become counterparty

The risk of a conflict of interests is to a large extent minimised if there is full disclosure of the fact that the representative wishes to act as the third party to the prospective contract, as in that case the principal is aware that the representative has potentially conflicting interests. Such a principal will be alerted to look critically into the question whether the prospective contract is beneficial. Accordingly, when the representative has disclosed the intention of being the third party and the principal does not object, the principal may be assumed to have given consent. In this situation, there is not sufficient reason not to allow the representative to be also the third party to the contract.

E. Self-contracting if intention not disclosed

The fact that the representative did *not* disclose the intention of acting as the third party should not prevent the representative from nevertheless doing so if either the principal otherwise knew or must have known that the representative would act as the third party. There is no substantial difference between those cases where it was the representative who disclosed the conflict and cases where the principal found out or was informed by another party of the fact that the representative would become the counterparty to the

prospective contract if in both of these types of cases the principal did not object to that situation.

F. Self-contracting if content of the prospective contract excludes risk of conflict of interests

Where the content of the prospective contract is very clearly determined in the mandate contract a conflict of interests is excluded. In such cases, the contract offered to the third party is more or less non-negotiable. The representative is then no longer in a position to further his or her own interests to the detriment of the principal as the terms of the prospective contract cannot be altered. If that is the case, there is not much risk that the interests of the principal would be jeopardised.

G. Self-contracting if principal is consumer

A principal-consumer may not be in a position to clearly evaluate whether the representative's own interests have led to a contract which is sub-optimal. In order to protect the principal from hasty decisions or even from giving consent by adhering to standard contract terms, this Article demands that consent must be given expressly, in writing or otherwise.

In order to properly protect the interests of the consumer and also to protect the trust in professional providers of mandate services, a more restrictive provision is needed where it comes to contracts between a business and a consumer. However, it is not in the interest of the consumer to completely exclude the possibility of the representative becoming the principal's counterparty to the prospective contract. The interests of the principal are sufficiently safeguarded with full disclosure of the identity of the representative and express consent by the principal for the particular transaction (paragraph (3)(a)). This implies that the principal cannot by way of agreeing to standard contract terms be forced to accept the representative becoming the counterparty to the prospective contract.

A conflict of interests is also deemed to be excluded in contracts between a business and a consumer when the content of the prospective contract is so precisely determined in the mandate contract that there is no risk that the interests of the principal may be disregarded (paragraph (3)(b)).

IV.D.–5:102: Double mandate

(1) The representative may not act as the representative of both the principal and the principal's counterparty to the prospective contract.

(2) The representative may nevertheless act as the representative of both the principal and the counterparty if:

(a) this is agreed by the parties in the mandate contract;

- (b) the representative has disclosed an intention to act as the representative of the counterparty and the principal*
- (i) subsequently expresses consent; or*
 - (ii) does not object to the representative acting as the representative of the counterparty after having been requested to indicate consent or a refusal of consent;*
- (c) the principal otherwise knew, or could reasonably be expected to have known, of the representative acting as the representative of the counterparty and the principal did not object within a reasonable time; or*
- (d) the content of the prospective contract is so precisely determined in the mandate contract that there is no risk that the interests of the principal may be disregarded.*
- (3) If the principal is a consumer, the representative may only act as the representative of both the principal and of the counterparty if:*
- (a) the representative has disclosed that information and the principal has given express consent to the representative acting also as the representative of the counterparty to the particular prospective contract; or*
 - (b) the content of the prospective contract is so precisely determined in the mandate contract that there is no risk that the interests of the principal may be disregarded.*
- (4) The parties may not, to the detriment of the principal, exclude the application of paragraph (3) or derogate from or vary its effects.*
- (5) If and in so far as the representative has acted in accordance with the previous paragraphs, the representative is entitled to the price.*

COMMENTS

A. General idea

This rule follows the same rationale as IV.D.-5:101 (Self-contracting): there is presumed to be a conflict of interests when the representative also acts as representative of the third party. The risk of a conflict of interests generally precludes the representative from representing properly both the principal and the third party to the prospective contract. The general rule is therefore that the representative is not allowed to do so.

However, there are exceptions to this general rule. Paragraph (2) deals with this matter. For consumers, a more restrictive approach is taken in paragraph (3). This more restrictive rule is mandatory to protect the consumer's interest (paragraph (4)). Paragraph (5) deals with the consequences as regards the payment of the price.

B. Main rule: double mandate not allowed

As the case is with self-contracting, a conflict of interests may arise between the interests of the principal and those of the representative if the latter represents both the principal and the third party with whom the prospective contract is to be concluded. This situation is of special relevance in mandate relationships, in which the representative's main

obligation is to act in the interest of the principal. The option chosen is to forbid this practice as a general rule, unless a conflict of interests is excluded.

C. Exceptions to general rule if conflict excluded

The ratio of the present Article follows that of IV.D.–5:101 (Self-contracting). By way of exception a double-mandate is allowed when a conflict of interests between the principal and the representative is excluded. This approach protects the interests of the principal, since it prevents the representative from advancing the interests of the third party while disregarding those of the principal. This is for example the case when the principal consents to the double representation, or when the prospective contract is so precisely defined in the mandate contract that a conflict of interests is excluded.

D. Double mandate if principal consumer

The Article grants extra protection to the interests of a principal who is a consumer. In such a case the principal's consent in writing is required if the representative wants to represent the third party. In cases where the consumer is not informed of the fact that the representative acts as representative of the third party, or is informed in a standard contract term only, the consumer may be caught unaware or even feel betrayed when the party entrusted with the negotiation of a contract appears to have used, or abused, that position by defending the conflicting interests of the other party to the prospective contract.

E. Payment in case of double mandate

The representative should be entitled to payment when in cases of permitted double representation. In this situation, the representative has done everything required under the contract and the services provided have led to the conclusion of the prospective contract. As the representative was allowed to act as the representative of the third party, the interests of the principal were not in jeopardy. Under these conditions, there seems to be no reason why the representative should not receive payment.

CHAPTER 6: TERMINATION BY NOTICE OTHER THAN FOR NON-PERFORMANCE

IV.D.–6:101: Termination by notice in general

(1) Either party may terminate the mandate relationship at any time by giving notice to the other.

(2) For the purposes of paragraph (1), a revocation of the mandate of the representative is treated as termination.

(3) Termination of the mandate relationship is not effective if the mandate of the representative is irrevocable under IV.D.–1:105 (Irrevocable mandate).

(4) The effects of termination are governed by III.–1:109 (Variation or termination by notice) paragraph (3).

(5) When the party giving the notice was justified in terminating the relationship no damages are payable for so doing.

(6) When the party giving the notice was not justified in terminating the relationship, the termination is nevertheless effective but the other party is entitled to damages in accordance with the rules in Book III.

(7) For the purposes of this Article the party giving the notice is justified in terminating the relationship if that party:

(a) was entitled to terminate the relationship under the express terms of the contract and observed any requirements laid down in the contract for doing so;

(b) was entitled to terminate the relationship under Book III, Chapter 3, Section 5 (Termination); or

(c) was entitled to terminate the relationship under any other Article of the present Chapter and observed any requirements laid down in such Article for doing so.

COMMENTS

A. General idea

This Article provides, first, that a notice of termination by either party has the effect of terminating the mandate relationship (paragraph (1)). In accordance with the general rules on notices in Book II, the termination is effective when the notice of termination reaches the other party or, if the notice so provides, when a period indicated in the notice has elapsed (II.–1:106 (Notice) paragraph (3)). The effects of termination are governed by the general rules in Book III, Chapter 1 on the effects of termination of a contractual relationship by notice. This means that termination has prospective effect only, subject to the restitution of certain benefits (III.–1:109 (Variation or termination by notice) paragraph (3)), but does not affect provisions for the settlement of disputes or other provisions intended to survive the termination of the mandate relationship.

The notice leads to the termination of the mandate relationship, whether or not the party giving notice had a right to terminate the relationship under the express terms of the contract or under the rule on termination for fundamental non-performance or under any other rule in the present Chapter, such as the rule on termination of a relationship of indefinite duration by giving notice of reasonable length. If there is such a right to terminate and if the requirements for such termination are observed (i.e. if the termination is justified within the meaning of paragraph (7)) no damages are payable for terminating the relationship (paragraph (5)). However, if there is no right to terminate under the express terms of the contract or under the provisions on fundamental non-performance or the equivalent or under any other rule of this Chapter, the aggrieved party will be entitled to damages (paragraph (6)). This applies also if the requirements for exercising such an other right to terminate were not observed – for example, if a reasonable period of notice is required but only an inadequate period of notice is given. As the mandate relationship

is ended, the aggrieved party is not entitled to claim specific performance of the obligations under the mandate contract, i.e. cannot force the party wrongfully terminating the mandate relationship to continue performance. The aggrieved party can however ask for specific performance of obligations relating to the settlement of disputes and other obligations which are intended to survive termination of the mandate relationship. This follows from the general rule in III.–1:109 (Variation or termination by notice) paragraph (3)(b).

According to paragraph (2) a notice of revocation of the mandate of the representative is to be treated as a notice by the principal terminating the mandate relationship.

B. Notice of termination effective, unless mandate irrevocable

Notice of termination in principle always effective. A notice of termination leads in any case to the termination of the mandate relationship, whether or not the party has a right to terminate under any other rule.

Relationship to general rule in Book III. The general rule under III.–1:109 (Variation or termination by notice) paragraph (1) is that a contractual relationship can be terminated by notice by either party “where this is provided for by the terms regulating it”. The present Article is an example of such a term. It is a default rule. The parties may include a different term in the mandate contract – for example, one providing that termination by notice will take place only after a period of a prescribed length. Given the nature of a mandate contract, however, such a term would be unusual as it would not be in the interests of the principal.

The character of mandate relationships, with their strong foundation in trust and confidence, suggests that the parties should not be compelled to continue the relationship once one of them has shown an intention to terminate it. If, for example, the representative were to be obliged to continue performance for a period after giving notice, it might be asked whether the representative would in fact be very active in concluding the prospective contract during that period. Similarly, there is a strong argument for not placing a principal in a situation where another person can affect the principal’s legal position after a notice of immediate termination of the relationship has been given. There is not after that time a strong basis in trust and confidence for a compulsorily continued mandate relationship.

No termination in case of irrevocable mandate. There is, however, one exception to the rule that the notice of termination always is effective, whether or not the conditions for termination have been met. This is the case where the mandate is irrevocable under IV.D.–1:105 (Irrevocable mandate). If termination of an irrevocable mandate were possible, the consequences of irrevocability could be easily circumvented by giving notice of termination. This is exactly what is not intended in the case of irrevocability. The present paragraph (3) therefore excludes the effectiveness of a notice of termination in the case of an irrevocable mandate.

C. Non-compliance with normal requirements for termination only relevant to liability in damages

There are some situations where a party to a mandate relationship has a right under other rules to terminate it by notice without being liable to pay damages for so doing. Paragraph (7) lists the relevant situations for present purposes. One such situation is where the contract itself confers an express right to terminate, perhaps after giving a reasonable period of notice. Another is where there has been fundamental non-performance (or the equivalent) by the other party of obligations under the contract. See Book III, Chapter 3, Section 5 (Termination). Other situations are provided for in the present Chapter. So far as the principal is concerned the relevant provisions are IV.D.–6:102 (Termination by principal when relationship is to last for an indefinite period or when mandate is for a particular task), which applies where the mandate relationship is not irrevocable and the mandate contract was concluded for an indefinite period or for a particular task, and IV.D.–6:103 (Termination by principal for extraordinary and serious reason). Under both provisions notice must be given. Under the first a notice period of reasonable length must be observed and under the second there must be an extraordinary and serious reason to terminate the contractual relationship immediately. For the representative, IV.D.–6:104 (Termination by representative when relationship is to last for indefinite period or when it is gratuitous) and IV.D.–6:105 (Termination by representative for extraordinary and serious reason) contain similar provisions. If the requirements of these provisions are observed, there is no liability in damages for the party who wants to terminate (paragraph (5)). If they are not observed, termination is still effective under the present Article according to the terms of the notice of termination but damages will be payable by the party giving notice (paragraph (6)).

D. Revocation of mandate of the representative implies termination of mandate relationship

Revocation of the mandate of the representative leads to the termination of the mandate relationship by the principal. By revoking the mandate, the principal takes away the core of the content of the mandate relationship and as a result the whole of the mandate relationship consequently comes to an end. For that reason, paragraph (2) provides expressly that revocation of the mandate of the representative is regarded as termination by notice under paragraph (1).

The fact that the principal is allowed to revoke the mandate and thereby terminate the mandate relationship does not mean that the revocation is always ‘free of charge’. As revocation of the mandate is treated as a termination, the rules of Chapter 6 apply. This implies that termination is in any case effective, but where the representative has not been guilty of fundamental non-performance or the equivalent and the principal does not have an extraordinary and serious reason to revoke or has not observed a notice period of reasonable length in terminating a contractual relationship of indefinite duration, the principal would be required to pay damages under paragraph (5) of the present Article.

When the principal concludes the prospective contract personally or by means of another representative this implicitly revokes the representative’s mandate to conclude that

contract on the principal's behalf (cf. IV.D.–1:104 (Revocation of the mandate) paragraph (2)). Under paragraph (2) of the present provision, revocation is treated as termination by notice. Since in the situation in which the principal concludes the prospective contract personally or by means of another representative the principal in effect terminates the contractual relationship without being entitled to do so under any of the provisions mentioned, the principal would be obliged to pay damages in accordance with III.–3:702 (General measure of damages).

D. Calculation of damages

Where the principal terminates the mandate relationship without being justified in doing so under paragraph (7) and where damages are consequently payable, the general rules on the calculation of damages come into operation. Under III.–3:702 (General measure of damages) the representative is entitled to be put as nearly as possible into the position in which the representative would have been if the principal's obligations under the mandate contract had been duly performed. In this respect it should be noted that, if the mandate contract has been concluded for an indefinite period or for a particular task, then – unless the parties have validly derogated from IV.D.–6:102 (Termination by principal when relationship is to last for an indefinite period or when mandate is for a particular task) – the principal may at any time terminate the mandate relationship by giving notice of reasonable length. In that case, the damage sustained by the representative is not the fact that the representative could not conclude the prospective contract, but the fact that the notice period was not observed and, therefore, that the representative has lost the chance of being able to conclude the prospective contract in the remaining period in which the mandate contract would have been in force. In these cases, the effect of III.–3:702 (General measure of damages) is to substitute a monetary sum for the reasonable notice period. Damages will be payable in lieu of a reasonable period of notice. Where the contract was concluded for a definite period then the damages would be for the loss of the chance of concluding the prospective contract in the remainder of the period.

E. Restitutionary effects of termination

The restitutionary consequences of termination are dealt with under paragraph (4). The effect of that paragraph is that the general rules in Book III, Chapter 3, Section 5, subsection 4 apply. These rules require a party who has received any benefit from the other's performance of the obligations under the contract to return the benefit. If the benefit is transferable it must be returned by transferring it. If the benefit is not transferable its value must be paid. (III.–5:111 (Restitution of benefits received by performance)). As any benefit received by the performance of the representative, in so far as it has already been rendered, cannot normally be transferred, the principal will have to pay the value of any performance which has been received but for which payment was not yet due at the time of termination. If payment had been due at the time of termination then it would remain due because termination has only prospective effect.

The method of calculating the payment due is laid down in III.–3:513 (Payment of value of benefit). Where a price is payable under the contract, the basic rule is that the payment due is that proportion of the price which the value of the actual performance (received but for which payment was not due at the time of termination) bears to the value of the

promised performance (III.–3:513 (Payment of value of benefit) paragraph (2)). Where a price per hour or day of work by the representative was payable under the contract the payment due will be calculated by reference to that price. Where, however, the price was due only if the prospective contract was concluded it will usually be difficult to argue that the representative is entitled to any restitutionary payment. The comparison then would be between what was promised (a result) and what was provided (no result). What this means is that if, in such “no result, no pay” cases, the representative terminates the relationship without justification before the result is achieved then the representative will receive nothing. If the principal terminates the relationship without justification before the result is achieved then the representative will receive nothing *by way of a restitutionary payment* but will be entitled to damages for the loss of the chance of concluding the prospective contract. If the representative had been on the point of concluding the prospective contract then these damages should approach or even equal the amount of the commission which would have been due.

IV.D.–6:102: Termination by principal when relationship is to last for indefinite period or when mandate is for a particular task

(1) The principal may terminate the mandate relationship at any time by giving notice of reasonable length if the mandate contract has been concluded for an indefinite period or for a particular task.

(2) Paragraph (1) does not apply if the mandate is irrevocable.

(3) The parties may not, to the detriment of the principal, exclude the application of this Article or derogate from or vary its effects, unless the conditions set out under IV.D.–1:105 (Irrevocable mandate) are met.

COMMENTS

A. General idea

Following the approach in III.–1:109 (Variation or termination by notice), the present Article provides the principal with a means to terminate a mandate relationship concluded for an indefinite period by giving notice of reasonable length. The Article follows the generally accepted principle that nobody can be contractually bound to another eternally. But this Part also extends this right of the principal to terminate by notice to those cases in which the contract has been concluded for a particular task. The justification for such solution is that this type of contract may give rise to a relationship where the parties are bound to each other eternally since it is uncertain when or if the envisaged result will be achieved.

B. Termination by notice of reasonable length when contract for an indefinite period

The principal is allowed to bring a mandate relationship entered into for an indefinite period to an end (even in the absence of an extraordinary and serious reason) provided

that the principal notifies the decision to terminate a reasonable time in advance in order to grant the representative some time to adapt to the new situation.

Whether a period is reasonable would have to be determined in the light of the relevant circumstances. These would include the time the contract has lasted, the efforts and investments which the representative has made in performing the contract, the time it may take the representative to obtain another contract, and any relevant usages or practices.

C. Termination contract for a particular task

A mandate relationship entered into for a particular task terminates when the particular task is completed (i.e. when the prospective contract is concluded). It is therefore not a contract concluded for an indefinite period but rather one for a definite period, despite the fact that the exact date of expiry is not known exactly. Under IV.D.–6:101 (Termination by notice in general), a principal who terminates a contract for a definite period before the agreed date of expiry (i.e. the specific date or the date when the envisaged result is achieved) is in principle liable in damages, unless there is some other legitimate reason for early termination.

However, under the present Article a principal is entitled to terminate a mandate relationship entered into for a *particular task* by giving notice of reasonable length and to do so without liability for damages. Although this type of contract could be classified as for a definite period, its specific characteristics are deemed to justify the right to terminate at any time by giving notice. Indeed, since it is uncertain when the envisaged result will be achieved or even whether it will be finally achieved, the parties may be *de facto* linked to the contract for an indefinite period, in particular in the situation where the representative fails to conclude the prospective contract without breaching the obligations under the mandate contract – in which case the mandate relationship cannot be terminated for non-performance either. However, the principal is not allowed under this Article to terminate the contract immediately: it is essential to give notice of reasonable length to the representative in order to provide some time for adjustment to the new situation.

Illustration 1

A principal entrusts an estate agent with the task of selling the principal's house without specifying a time within which this is to be done. After a year and a half the house has still not been sold, even though the principal has twice given the estate agent a direction to reduce the price. At that moment, the number of sales of houses has dropped significantly and it does not appear that the housing-market will soon recover. For these reasons, the principal finally decides not to pursue the attempt to sell the house.

In this situation the principal can terminate the mandate relationship, without incurring liability for damages for so doing, by giving a reasonable period of notice.

D. No termination if irrevocable mandate

For obvious reasons paragraph (2) of the Article provides that the principal's right to terminate under paragraph (1) does not apply in the case of an irrevocable mandate.

E. Mandatory character of the rule

The principal's right to terminate the mandate relationship for an indefinite period of time or a particular task is mandatory in favour of the principal – whether the principal is a consumer or a business. If the parties could not terminate a mandate relationship entered into for an indefinite period of time, the contract would in fact be concluded for eternity, and this is considered to be contrary to public policy or good morals in many legal systems. Moreover, if the parties could exclude the right to terminate the mandate relationship, this would undoubtedly lead to a stretching of the notion of 'extraordinary and serious reason' under the following Article, thus enabling the principal to escape from the contract, but without even having to observe a notice period of reasonable length. For these reasons, the parties are not allowed to derogate from this Article to the detriment of the principal. This idea is expressed in paragraph (3).

IV.D.–6:103: Termination by principal for extraordinary and serious reason

(1) The principal may terminate the mandate relationship by giving notice for extraordinary and serious reason.

(2) No period of notice is required.

(3) For the purposes of this Article, the death or incapacity of the person who, at the time of conclusion of the mandate contract, the parties had intended to execute the representative's obligations under the mandate contract, constitutes an extraordinary and serious reason.

(4) This Article applies with appropriate adaptations if the successors of the principal terminate the mandate relationship in accordance with IV.D.–7:103 (Death of the principal).

(5) The parties may not, to the detriment of the principal or the principal's successors, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The present Article introduces a right for the principal to immediately terminate a mandate relationship without having to observe a notice period and without having to pay damages. This right can be exercised when there is an extraordinary and serious reason which justifies termination provided that the principal notifies the representative of the decision to terminate the mandate relationship. Extraordinary and serious reasons to terminate a mandate relationship may arise in very different circumstances. Paragraphs

(3) and (4) mention two situations which are classified as extraordinary reasons to terminate. This rule has a mandatory character.

B. No exhaustive list of extraordinary and serious reasons

This provision refers in paragraph (3) and (4) to two situations which are to be regarded as extraordinary reasons which justify termination: the death or incapacity of the person who, at the time of conclusion of the mandate contract, the parties had intended to execute the representative's obligations under the mandate contract (paragraph (3)) and, for the successors of the principal, the death of the principal (paragraph (4)). This list does not purport to provide an exhaustive enumeration of the reasons that justify immediate termination. Whether a reason qualifies as extraordinary and justifies immediate termination is to be determined on a case-by-case basis.

Termination by the principal for an extraordinary and serious reason may occur when the principal no longer believes that the representative is acting in the principal's best interest and has lost trust in the representative. This may, for instance, occur when the representative has breached an implied or explicit obligation of confidentiality. There may also be an extraordinary and serious reason to terminate for the principal if the result to be achieved by the representative has become pointless for the principal.

Illustration 1

Marco concludes a mandate contract in which he entrusts Julka with the task of negotiating the purchase of a major bank. The following week a fraud case involving Julka is reported on the front page of all national newspapers. Whether or not the accusations are true, Julka's business reputation is seriously damaged and Marco does not have sufficient trust in Julka being able, at this time, to properly negotiate with the current owners of the bank. Even though there is no case of non-performance by the representative, under these circumstances the principal cannot be expected to continue allowing the representative to take care of the transaction.

However, there is no provision stating that whenever the principal justifiably loses trust and confidence in the representative, there is a serious and extraordinary reason for termination of the mandate relationship. Such an explicit rule could tempt principals to argue that there would be a loss of confidence and trust just to escape having to respect a notice period or, after the fact, to prevent having to pay damages for wrongfully terminating the mandate relationship with immediate effect. It is thought better to leave the matter for the court to decide on the basis of the general clause of paragraph (1).

C. No notice period

If there is indeed an extraordinary and serious reason which justifies termination of the contract, termination should take immediate effect. In this specific situation the party giving notice is not required to observe any other condition than notifying the other party about the decision to terminate. In particular, no notice period needs to be observed, as

follows from paragraph (2). It follows from the general rules on notice in II.-1:106 (Notice), that there is no form requirement regarding the notification.

D. Relation to termination for non-performance

In many cases where the principal has an extraordinary and serious reason to terminate the contractual relationship, there will also be a fundamental non-performance by the representative allowing the principal to terminate. Termination of the mandate relationship under the present Article does not as such entitle the principal to damages, whereas this will normally be the case when the principal terminates the contractual relationship for fundamental non-performance.

E. Relation to rule on change of circumstances

In some circumstances, III.-1:110 (Variation or termination by court on a change of circumstances) may be applicable. If such is the case parties would be expected to enter into negotiations to adapt the contract or to terminate it. If negotiations fail it is for the judge to decide whether the contract is to be terminated or to be adapted. Under the present Article (and the corresponding provision in IV.D.-6:105 (Termination by representative for extraordinary and serious reason)) the party who does not want to continue performance can terminate with immediate effect. The party who has an extraordinary and serious reason to terminate is discharged of the burden of trying to negotiate with the other party and of going to court in order to bring the relationship to an end.

F. Mandatory character of the rule

The right to terminate the mandate relationship for extraordinary and serious reason is mandatory, as is expressed in paragraph (4). This cannot reasonably be otherwise if the right to terminate for extraordinary and serious reason is to mean anything in practice, as the parties by way of standard contract terms could effectively exclude its application. This would in fact mean the exclusion of the good faith principle, which underlies the present Article.

IV.D.-6:104: Termination by representative when relationship is to last for indefinite period or when it is gratuitous

(1) The representative may terminate the mandate relationship at any time by giving notice of reasonable length if the mandate contract has been concluded for an indefinite period.

(2) The representative may terminate the mandate relationship by giving notice of reasonable length if the representative is to represent the principal otherwise than in exchange for a price.

(3) The parties may not, to the detriment of the representative, exclude the application of paragraph (1) of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

In the normal case the mandate relationship will terminate when the representative has concluded the prospective contract on behalf of the principal. There may be situations, however, in which the representative no longer wants to continue to carry out the contractual obligations even though the prospective contract has not been concluded. The present Article enables the representative to terminate the mandate relationship, if the contract is for an indefinite period of time or provides for gratuitous representation, by giving notice of reasonable length.

B. Termination by notice when mandate contract concluded for indefinite period

Following the regime in III.–1:109 (Variation or termination by notice) paragraph (2), the present Article allows the representative, as is the case with the principal, to terminate a mandate contract for an indefinite period by giving notice of reasonable length. Representatives are not to be compelled to be bound to their principals eternally, but if they want to end a relationship entered into for an indefinite period they do have to give the principal notice of reasonable length. Notification is designed to give the principal enough time to adapt to the new situation, e.g. to find another representative.

C. Termination by notice when representative not entitled to remuneration

Traditionally, the mandate contract was considered to be of a gratuitous nature. This is no longer the case. Nevertheless, some mandate contracts are still performed gratuitously, for instance when the parties did not agree upon a price and the representative did not act in the performance of a business or profession, or because the representative has waived the right to payment – which may have been done for commercial or personal reasons.

When the mandate contract is not remunerated, some specific provisions apply. IV.D.–2:103 (Expenses incurred by representative) paragraph (2) explicitly entitles the representative to the reimbursement of reasonable expenses. Moreover, the non-remunerated nature of the mandate contract influences the care that may be expected of the representative, cf. IV.D.–3:103 ((Obligation of skill and care) paragraph (2)(c). However, as a general rule the position of a representative acting gratuitously does not differ much from the position of a remunerated representative. This implies that the obligations resulting from the mandate contract may become too burdensome for the representative. The representative is granted the right to be freed from these obligations by giving notice of the termination of the mandate relationship, provided the period of notice is of reasonable length. This applies even if the gratuitous mandate relationship was entered into for a definite period.

D. Character of the rule

For the reasons explained above in relation to the principal's corresponding right it is generally regarded as contrary to public policy to bind parties to contracts for eternity. Moreover, again for the reasons explained above, it is necessary to make the provision on contracts for indefinite duration mandatory.

Paragraph (2) regarding the right to termination of a non-remunerated contract contains a default rule from which the parties may derogate.

IV.D.–6:105: Termination by representative for extraordinary and serious reason

(1) The representative may terminate the mandate relationship by giving notice for extraordinary and serious reason.

(2) No period of notice is required.

(3) For the purposes of this Article an extraordinary and serious reason includes:

(a) a change of the mandate contract under IV.D.–4:201 (Changes of the mandate contract);

(b) the death or incapacity of the principal; and

(c) the death or incapacity of the person who, at the time of conclusion of the mandate contract, the parties had intended to execute the representative's obligations under the mandate contract.

(4) The parties may not, to the detriment of the representative, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The present Article introduces a right for the representative to immediately terminate a mandate relationship, no matter whether the contract has been concluded for a definite or indefinite period, without having to observe a notice period and without having to pay damages. This applies when the representative can invoke an extraordinary and serious reason which justifies termination.

Extraordinary and serious reasons to terminate a mandate relationship may arise in very different circumstances. Paragraph (3) provides a non-exhaustive list: if the principal changes the contract, if the principal dies or becomes incapable and if the person who, at the time of conclusion of the mandate contract, the parties had intended to execute the representative's obligations under the mandate contract, dies or is becomes incapable.

B. No exhaustive list of extraordinary and serious reasons

In many cases the well-founded loss of trust and confidence in the principal will constitute an extraordinary and serious reason for the representative to terminate a

mandate relationship. In these cases, the confidence in the other party was necessary for the proper performance of the obligations under the mandate contract. The present Article introduces accordingly a right for the representative to immediately terminate a mandate relationship without having to observe a notice period and without having to pay damages. However, it does not seem to be wise to include a general provision stating that whenever the representative justifiably loses his trust and confidence in the principal, there is a serious and extraordinary reason for termination of the mandate relationship. Such an explicit rule could tempt representatives to argue that there would be a loss of confidence and trust just to escape having to respect a notice period or, after the fact, to prevent having to pay damages for wrongfully terminating the mandate relationship with immediate effect. It is thought better to leave the matter for the court to decide on the basis of the general clause of paragraph (1).

Illustration 1

A principal mandates a representative to negotiate the purchase of a major bank. The following week a fraud case implicating the principal is reported on the front page of all national newspapers. Whether or not the accusations are true, the principal's business reputation is damaged. As the representative is dependent on an unimpeachable business reputation, the representative needs to be able to bring the relationship with this principal to an end as soon as possible. Even though there is no case of non-performance by the principal, under these circumstances the representative cannot be expected to continue performance under the mandate contract.

C. No notice period

If there is indeed an extraordinary and serious reason which justifies termination of the contractual relationship, termination should take immediate effect. In this specific situation the representative should not be required to observe any other condition than notifying the principal about the decision to terminate. In particular, no notice period needs to be observed, as indicated in paragraph (2). There is no form requirement regarding the notification.

D. Relation to rule on change of circumstances

In some circumstances, III.-1:110 (Variation or termination by court on a change of circumstances) may be applicable. If such is the case the parties would be expected to enter into negotiations to adapt the contract or to terminate the relationship. If negotiations fail it is for the judge to decide what is to be done. This would, however, all take a long time, during which there is uncertainty as to the position of the parties. Where the representative can terminate the mandate relationship for an extraordinary and serious reason, this long process and the possible need of an application to the court is avoided.

F. Mandatory character of the rule

The right to terminate the mandate relationship for extraordinary and serious reason is mandatory, as is expressed in paragraph (4), for the reasons given in Comments F to IV.D.—6:103 (Termination by principal for extraordinary and serious reason).

CHAPTER 7: OTHER PROVISIONS ON TERMINATION

IV.D.–7:101: Conclusion of the prospective contract

(1) If the mandate contract was concluded solely for the conclusion of a specific prospective contract the mandate relationship terminates when the representative has concluded the prospective contract and the representative has informed the principal of that in accordance with paragraph (1) of IV.D.–3:402 (Giving account to principal).

(2) If the mandate contract was concluded solely for the conclusion of a specific prospective contract the mandate relationship terminates when the principal or another representative appointed by the principal has concluded the prospective contract. In such case, the conclusion of the prospective contract is treated as a notice under IV.D.–6:101 (Termination by notice in general).

COMMENTS

A. General comment

This Article is the first of four Article dealing with ways – other than termination by notice – by which a mandate relationship may come to an end. Termination for fundamental non-performance is not dealt with in this Part of Book IV, but in Section 5 of Chapter 3 of Book III. Termination by notice other than for fundamental non-performance or the equivalent is dealt with in the preceding Chapter of this Part. The present Chapter deals with four more specific types of termination, indicated by the titles of the relevant Articles – IV.D.–7:101 (Conclusion of the prospective contract); IV.D.–7:102 (Expiry of fixed period); IV.D.–7:103 (Death of the principal) and IV.D.–7:104 (Death of the representative).

B. No provision on termination in case of incapacity of principal or representative

In most Member States the supervening incapacity of the principal or that of the representative is also regarded as bringing the mandate relationship to an end. The laws on the legal effects of mental incapacity, however, differ from one country to another. Some countries have special regimes for mandates with a view to incapacity or enduring powers of attorney.

In most Member States the incapacity of the principal is regarded as a cause for termination: Belgium, Cyprus, France, Greece, Hungary, Ireland, Portugal and Sweden. The same is true for Italy, unless the mandate was for the conclusion of a contract pertaining to business activities and the business of the principal remains in operation. In Spain, the incapacity of the principal also leads to the termination of the mandate relationship, unless the contract indicates otherwise or unless the mandate relationship was precisely concluded for the situation that the principal would later be declared

incapable. In this case, the mandate relationship remains in force in accordance with the conditions imposed by the principal.

The contractual relationship does not terminate when the principal is declared incapable in Austria, the Netherlands, Poland and Slovakia. It follows that in those legal regimes the mandate relationship continues between the representative and the curator of the principal. In England, the mandate relationship terminates unless the Enduring Power of Attorney Act applies.

If the incapacity of the principal terminates the mandate relationship, the relevant moment is the moment when the incapacity is declared by a court or specific body in France, Lithuania, Slovakia and Spain. In most other systems the relevant moment is the moment the representative becomes aware of the incapacity. Among these systems it is possible to differentiate two sub-groups. In a first group of systems, the relationship is deemed to be terminated when the representative knows or ought to have been aware of the incapacity of the principal. This is the regime in Belgium, Greece, Hungary, Italy, and Portugal. In a second group of systems, the relevant moment is when the representative is informed of the incapacity. This is the case in Cyprus, Poland, and Scotland. In this second group, the burden of proof regarding whether the representative was aware of the incapacity seems to lie on the person charged with protecting the interests of the incapacitated principal.

The representative has the obligation to continue performance in order to prevent detriment to the interests of the principal or the principal's successors in Austria, Belgium, Cyprus, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Lithuania, the Netherlands, Portugal, Scotland, Slovakia and Spain. In England, the representative has to wait for instructions from the successors of the principal. In most countries, the representative seems only to be obliged to continue running the affairs that were already started before the principal was incapacitated. This is the case in Belgium, Cyprus, Greece, Italy, Portugal, Scotland and Spain. In some of these systems, the representative would also be obliged to take urgent measures. This is the case in Italy and the Netherlands. In Slovakia the representative is only obliged to take urgent measures. In some systems, the obligation to perform these measures is subject to a time-limit: the representative has to continue until the curator can take over the responsibility. This is the case in Germany, Greece, Hungary, and Lithuania. In the Netherlands, the time-limit is specific: one year.

The representative is entitled to payment in Austria, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Scotland, and Slovakia. In the Netherlands, the representative is entitled to payment if and in so far as this is reasonable in view of the circumstances.

In almost all European legislations, the supervening legal incapacity of the representative implies the termination of the mandate relationship. As far as is known, this is different only in Austria and Sweden.

As was said above, the rules on the legal effects of mental incapacity differ greatly from one country to another. Given the fact that the law governing mental incapacity is not covered by these model rules, it is thought that the question whether or not the supervening incapacity of either party to the mandate relationship should lead to the end of the mandate relationship – and what the consequences should be if that happens – is best left to national law.

C. No provision for termination in case of bankruptcy

In all Member States bankruptcy law determines whether or not the mandate relationship terminates by the bankruptcy of either the principal or the representative.

The bankruptcy of the principal terminates the mandate relationship in Austria, Cyprus, England, France, Germany, Greece, Hungary, Ireland, Italy, Lithuania, Slovakia, Scotland, Spain and Sweden. The same holds true for Estonia, unless the carrying out of the mandate does not affect the bankruptcy. In Poland, the bankruptcy of the principal does not terminate the mandate relationship. In Portugal, the same is true, as it is thought that such a provision is not needed: where relevant, both the person charged with the bankruptcy and the representative can simply terminate the mandate relationship by giving notice.

In many Member States the public declaration of bankruptcy implies the termination of the mandate relationship. This is the case in Austria, Cyprus, Greece, Slovakia, Spain and Sweden. In other countries, notably Belgium, Estonia, France, Germany, Ireland, Italy, and Lithuania, the mandate relationship only terminates when the representative becomes aware of it.

The declaration of bankruptcy of the representative also leads to the termination of the mandate relationship in the majority of the legal systems. However, in some of these systems there is no termination if the mandate relationship is not related to the bankruptcy. This is explicitly indicated for Austria, Estonia and Ireland. In England, Germany, and Hungary the mandate relationship does not automatically end. This is also the case for the Netherlands, where under bankruptcy law the mandate relationship may, however, be terminated by the person charged with the bankruptcy.

In all Member States bankruptcy law determines whether or not the mandate relationship ends by the bankruptcy of either the principal or the representative. Given the fact that bankruptcy law is not covered by these model rules, it is thought that the question whether or not the bankruptcy of either party to the mandate relationship should lead to the end of the mandate relationship – and what the consequences should be if it is so terminated – is best left to national law.

D. Conclusion of the prospective contract

Paragraph (1) of the present Article refers to the typical way in which the mandate relationship comes to an end: by the conclusion of the prospective contract by the representative. When the mandate contract was concluded for a specific task – which is the normal situation – and that specific task is fulfilled by the conclusion of the

prospective contract by the representative, this of course means that the mandate relationship is no longer in force. The Article provides that the moment of termination is when the representative has informed the principal of the conclusion of the prospective contract, as stated in IV.D.–3:402 (Giving account to principal) paragraph (1).

If it is not the representative but the principal or another representative appointed by the principal who has concluded the prospective contract, paragraph (2) of the present Article provides that the mandate relationship terminates in such a cases as well. In such a situation, the performance of the main obligation under the mandate contract becomes impossible as a result of an act by the principal or another representative appointed by the principal. Such an act is to be regarded as a form of termination of the mandate relationship under Chapter 6. In many cases, this will imply that the principal will be liable for damages for non-observance of the reasonable notice period.

IV.D.–7:102: Expiry of fixed period

(1) If the mandate contract was concluded for a definite period the mandate relationship terminates when that period expires.

(2) If the parties continue performance of the obligations under the mandate contract after the definite period has expired, the parties are treated as having concluded a mandate contract for an indefinite period.

(3) If the mandate relationship has terminated under paragraph (1) the representative is entitled to reimbursement of the reasonable costs incurred.

(4) If payment of a price based on a particular rate was agreed, the representative is entitled to payment of the price on the basis of that rate.

COMMENTS

A. General idea

When the mandate contract was concluded for a definite period the mandate relationship ends when the definite period has elapsed (paragraph (1)). If the definite period has elapsed but both parties continue performing the obligations under the mandate contract, the contract becomes one for an indefinite period (paragraph (2)). This means that from that moment on, both parties may nevertheless terminate the mandate relationship by giving notice of reasonable length, see IV.D.–6:102 (Termination by principal when relationship is to last for an indefinite period or when mandate is for a particular task) and IV.D.–6:104 (Termination by representative when relationship is to last for indefinite period or when it is gratuitous). The parties may, of course, derogate from this rule, e.g. by providing that the mandate relationship is continued for (again) a definite period of time, thus limiting the possibilities for the parties to prematurely terminate the renewed mandate relationship.

B. No entitlement to price

As the services of the representative have not led to the conclusion of the prospective contract, the representative is not entitled to payment for the services, unless the parties have agreed otherwise.

C. Conclusion of the prospective contract after termination of mandate relationship

It should be noted that IV.D.–2:102 (Price) paragraph (5) remains applicable if the prospective contract is concluded after the mandate relationship has terminated and the conclusion of the prospective contract can be mainly attributed to the performance of the mandate by the representative or the breach by the principal of a contractual provision.

IV.D.–7:103: Death of the principal

(1) The death of the principal does not end the mandate relationship.

(2) Both the representative and the successors of the principal may terminate the mandate relationship by giving notice of termination for extraordinary and serious reason under IV.D.–6:103 (Termination by principal for extraordinary and serious reason) or IV.D.–6:105 (Termination by representative for extraordinary and serious reason).

COMMENTS

A. General idea

Under the present Article, the mandate relationship does not terminate if the principal dies. The position of the principal is to be taken over by the successors (i.e. heirs or executors). This approach presumes that the interest of the principal may very well be the same as those of the successors and that they can continue the relationship. Yet, as the interests of the principal may be different from those of the successors, they should be entitled to escape from the mandate relationship without having to observe a notice period. Similarly, as it may become more onerous for the representative to have to deal with the whole of the successors – with possibly conflicting views on the pursuit of their interests – the representative should also be able to escape from the mandate relationship. For these reasons, both the representative and the successors of the principal may give notice of termination of the mandate relationship for extraordinary and serious reasons under IV.D.–6:103 (Termination by principal for extraordinary and serious reason) or IV.D.–6:105 (Termination by representative for extraordinary and serious reason).

B. Conclusion of the prospective contract after termination of mandate relationship due to the death of the principal

It should be noted that IV.D.–2:102 (Price) paragraph (5) remains applicable if the prospective contract is concluded after the mandate relationship has terminated and the

conclusion of the prospective contract can be mainly attributed to the performance of the mandate by the representative.

IV.D.–7:104: Death of the representative

(1) The death of the representative ends the mandate relationship.

(2) The expenses and any other payments due at the date of death remain payable.

COMMENTS

A. General idea

According to this provision, the death of the representative brings the mandate relationship to an end. This approach implies that it is by virtue of the personal characteristics of the representative that the principal entrusts the representative with the responsibility to carry out actions on the principal's behalf. Accordingly, the relationship ends if the representative cannot comply with the contractual obligations any longer (paragraph (1)).

B. Obligation to pay remains

The successors of the deceased representative will take the representative's place as creditor of the payment obligation. The provisions under IV.D.–2:102 (Price) paragraph (5) and IV.D.–2:103 (Expenses incurred by representative) apply. The effect of the former is that the price will often be payable if the prospective contract is concluded after the mandate relationship has ended due to the death of the representative and the conclusion of the prospective contract can be mainly attributed to the performance of the mandate by the representative.

C. Contract may provide otherwise

There may be cases where the mandate relationship does not depend on the personal qualities of the representative and where the fact that the representative dies does not by itself mean that the obligations under the contract can no longer be performed. If the representative dies, often colleagues or employees can carry out the performance of the obligations. In such a case, automatic ending of the mandate relationship may therefore not be in the interests of any of the parties involved. It is for the parties to explicitly agree on this.

PART E. COMMERCIAL AGENCY, FRANCHISE AND DISTRIBUTORSHIP

CHAPTER 1: GENERAL PROVISIONS

Section 1: Scope

IV.E.–1:101: Contracts covered

(1) This Part of Book IV applies to contracts for the establishment and regulation of a commercial agency, franchise or distributorship and with appropriate adaptations to other contracts under which a party engaged in business independently is to use skills and efforts to bring another party's products on to the market.

(2) In this Part, "products" includes goods and services.

COMMENTS

A. General idea

The rules in this Part of Book IV apply primarily to contracts for the establishment and regulation of a commercial agency, franchise or distributorship. These contracts have many characteristics in common, especially their economic function – the establishment and regulation of a marketing relationship. The rules relating to these common characteristics are to be found in Chapter 2. However, there are also some differences. Therefore, this Part also contains separate Chapters on commercial agency (Chapter 3), franchise (Chapter 4) and distribution (Chapter 5).

The Part applies not only to these contracts, but also with appropriate adaptations to all other contracts whereby an independent business person is to use skills and efforts to bring another party's products on to the market – i.e. to contracts which do not fall exactly within one of the three categories mentioned but which nevertheless have the same economic function of regulating a marketing relationship (vertical agreements; compare Article 2(1) EC Regulation 2790/1999 and Guidelines on Vertical Restraint, no.24) This wider application means that parties cannot avoid the application of the rules contained in this Part (especially the mandatory ones) by labelling, classifying or drafting their marketing relationship contract in such a way as to avoid calling it a commercial agency, franchising or distribution contract.

B. Not advertising contracts

However, the reference to other contracts under which an independent business person is to use skills and efforts to bring another party's products on to the market is not meant to refer to advertising contracts which are contracts of a different nature than the ones under discussion here: an advertising company will never itself sell the other party's products (goods or services) to the public or to another link in the distribution chain, either in its own name (as distributors and franchisees do) or in the name of the principal (as an agent may do). In other words, advertisers are not a link in the chain between producers and final users. Rather, they provide a service to one of the links which is meant to assist it to be more effective in bringing its products on to the market.

C. Independent business persons; not employees

The concept of independent business person includes both natural persons and legal persons. Indeed, in practice commercial agents, franchisees and distributors (especially the larger ones) are frequently companies which have legal personality according to the applicable national law.

However, it does not include – and therefore the rules contained in this Part do not apply to – persons who bring another party’s products on to the market otherwise than as independent business persons. The typical example of a person who is *not* independent is an employee. In other words, nothing in this Part is meant to cover labour contracts.

D. Products

This Article refers to “bringing *products* on to the market”. The concept of “products” includes here and throughout this Part both goods and services. (In the same sense Article 1 (a) EC Regulation 2790/1999; see also Guidelines on Vertical Restraints (2000/C 291/01, no. 2)).

Section 2: Other general provisions

IV.E.–1:201: Priority rules

In the case of any conflict:

- (a) the rules in this Part prevail over the rules in Part D (Mandate); and*
- (b) the rules in Chapters 3 to 5 of this Part prevail over the rules in Chapter 2 of this Part.*

COMMENTS

This Article is intended, first, to regulate questions of priority between the rules in this Part and the rules in the Part on Mandate. This is particularly relevant in relation to the rules on commercial agency. A commercial agent may, or may not, have a mandate to conclude contracts and do other juridical acts on behalf of the principal. In so far as there is such a mandate the agent will fall both under the rules on commercial agency and the rules on mandate. To a large extent these rules supplement each other but to the extent that there is any conflict the rules on commercial agency, which regulate a more specific situation and which have a stronger protective policy content, prevail. The second subparagraph is intended merely to resolve any doubts about the relationship between Chapter 2 and the subsequent Chapters of this Part. The important point is that the general rules for all marketing relationship contracts in Chapter 2 apply to the specific types of contract covered in the subsequent Chapters, subject to any particularisation or adaptation in those Chapters.

IV.E.–1:202: Derogation

The parties may exclude the application of any of the rules in this Part or derogate from or vary their effects, except as otherwise provided in this Part.

COMMENTS

This Article makes it clear that the rules in this Part are merely default rules unless otherwise provided. It is a particular application of the principle of party autonomy in II.–1:102 (Party autonomy). The application of that principle is particularly important in relation to the contracts within this Part because most such contracts are in practice governed by carefully drawn up contract terms.

There are a number of exceptions to the general rule in this Article. These are clearly stated in the relevant Articles. Their general justification is that the rules in question exist for the protection of the weaker party.

CHAPTER 2: RULES APPLYING TO ALL CONTRACTS WITHIN THE SCOPE OF THIS PART

Section 1: Pre-contractual

IV.E.–2:101: Pre-contractual information duty

A party who is engaged in negotiations for a contract within the scope of this Part has a duty to provide the other party, a reasonable time before the contract is concluded and so far as required by good commercial practice, with such information as is sufficient to enable the other party to decide on a reasonably informed basis whether or not to enter into a contract of the type and on the terms under consideration.

COMMENTS

A. General idea

This Article imposes upon each party a pre-contractual duty to provide the other with all the information which the other party needs to make a rational decision as to whether or not to enter into a contract of the type and on the terms under consideration. The information must be given a reasonable time before the contract is concluded. Reflecting the rule on pre-contractual information duties in relation to contracts between businesses for the supply of goods and services (II.–3:101 (Duty to inform about goods and services)) the duty is limited to what is required by good commercial practice. The main consequence of a failure to perform the duty is that the contract will be voidable for mistake.

B. Interests at stake and policy considerations

This duty to provide adequate pre-contractual information is intended to guarantee that each party will have all the relevant and necessary information in order to commit itself with full knowledge of the relevant facts. This is important because commercial agency, franchise and distribution contracts are often concluded for a long period and their conclusion (“entrance fee”) and the performance of the obligations under them frequently imply important investments. A party interested in concluding such a contract often has no way of obtaining the relevant information from any source other than the other party.

C. Relation to Book II

Book II, Chapter 3 contains provisions on information duties at the pre-contractual stage. These duties do not specifically focus on the commercial agency, franchise or distribution situations. Indeed most of them are framed in such terms (e.g. businesses supplying goods or services to consumers) that they would not apply to contracts within the scope of this Chapter. This Article is therefore necessary.

Also relevant are the provisions in II.–3:301 (Negotiations contrary to good faith and fair dealing), II.–7:201 (Mistake) and II.–7:205 (Fraud).

The present Article provides a specific rule for the pre-contractual duty to inform in commercial agency, franchise and distribution and similar marketing contracts. This rule may be considered as a special instance for these contracts of the general pre-contractual duty to

negotiate in accordance with good faith and fair dealing. In the context of the provisions on fraud, paragraph (3) of II.-7:205 (Fraud) states:

In determining whether good faith and fair dealing required a party to disclose particular information, regard should be had to all the circumstances, including: (a) whether the party had special expertise; (b) the cost to the party of acquiring the relevant information; (c) whether the other party could reasonably acquire the information by other means; and (d) the apparent importance of the information to the other party.

The present pre-contractual duty to inform is based on policy considerations which are closely related to these four factors.

D. Within a reasonable time

The time requirement included in the present provision aims to guarantee that the other party has sufficient time at its disposal in order to ponder on the basis of the information whether or not to enter the contract under consideration. In assessing whether the pre-contractual information is given within a reasonable time criteria such as the circumstances of the case or any applicable usage will fall to be taken into consideration.

E. Information required

The information which is to be given is such information as is sufficient to enable the other party to decide on a reasonably informed basis whether or not to enter into a contract of the type and on the terms under consideration. This means among other things that the information must be correct, complete and transparent. Depending on the circumstances of the case, especially the type of contract and the branch of trade, the types of information which must be given may include information regarding one's own company and experience, intellectual property rights which are involved, particular features of the commercial sector, market conditions, the structure and extent of the network, remuneration and fees and the terms of the contract.

The provision that only such information need be given as is required by good commercial practice is intended to place reasonable bounds on the scope of the information to be supplied. Contracts should not be open to attempts to avoid them on the ground that some item of information which one party considered relevant (perhaps, for example, information about the personal circumstances or political views of the other party) was not supplied.

For franchise contracts IV.E.-4:102 (Pre-contractual information) provides a detailed list of information which the franchisor must give to the franchisee before the conclusion of the contract. That list is mandatory (see paragraph (3) of that Article).

F. Remedies

The sanction for non-compliance is that the contract may be avoidable under II.-7:201 (Mistake). Paragraph (1) (b) (iii) of that Article specifically refers to the situation where one party caused the contract to be concluded in mistake by failing to comply with a pre-contractual information duty. All the ordinary rules on mistake apply, including liability those under II.-7:203 (Adaptation of contract in case of mistake) and II.-7:204 (Liability for loss caused by incorrect information).

Section 2: Obligations of the parties

IV.E.–2:201: Co-operation

The parties to a contract within the scope of this Part of Book IV must collaborate actively and loyally and co-ordinate their respective efforts in order to achieve the objectives of the contract.

COMMENTS

A. General idea

Co-operation is essential to commercial agency, franchise and distribution contracts and indeed to most other long-term commercial contracts. Each party heavily depends on the other party's co-operation for attaining its objectives. The obligation spelled out here explicitly recognises that the parties to such contracts are under an intense obligation to co-operate actively and loyally in order to achieve the objectives for which the contract was concluded.

Indeed, many (if not most) of the specific obligations spelled out in this Part may be regarded as special instances of this general intense obligation to co-operate actively and loyally (e. g. specific obligations relating to information, assistance, instructions, supervision, confidentiality et cetera). In addition to these specific rules, this Article makes sure that both parties are, more generally, under this intense obligation to co-operate which may be the source of other specific obligations to be established and further elaborated by the courts and arbitrators.

Although the intensity of the required co-operation may vary among them (it is usually strongest in franchise contracts), the obligation to co-operate in commercial agency, franchise and distribution contracts, and similar contracts establishing and regulating a marketing relationship, is more intense than in other contracts. The general obligation to co-operate in order to give full effect to the contract, which each party to any contract owes to the other according to III.–1:104 (Co-operation), is mainly limited in some contracts (e. g. most sales contracts) to an obligation to allow the other party to perform its obligations and thereby earn the fruits of performance stipulated in the contract, which is similar to the doctrine of *mora creditoris* in many civil law countries.

B. Interests at stake and policy considerations

Although each party may have a short-term interest in exclusively pursuing its own interests, even at the expense of the other party, in the long term both parties benefit from a steady co-operation where each of them not only takes the other party's interests into account but actively helps the other party to realise its goals. Both parties have an interest in actively demonstrating their commitment in the long term in order to pursue the reciprocal advantages deriving from their co-operation. This Article aims to encourage participation in exchange and to promote reciprocity between the parties. In addition, the Article takes into account the fact that during the course of commercial agency, franchise, distribution contracts and similar marketing relationship contracts contingencies may occur which the parties had not foreseen when they concluded the contract, contingencies which do not necessarily justify the application of III.-1:110 (Variation or termination by court on a change of circumstances). It

follows from the present Article that the parties should collaborate in overcoming such contingencies and in adapting to the new situation in such a way that the objectives of the contract can be achieved.

C. Relation to general obligation to co-operate

For contracts within the scope of this Part the duty to co-operate which is contained in III.–1:104 (Co-operation) is particularly intense. It is not sufficient for a party to a commercial agency, franchise or distribution contract to passively allow the other party to perform its obligations and thereby earn the fruits of performance stipulated in the contract (see III.–1:104 (Co-operation) Comment A). Rather, the parties should collaborate actively and loyally in order to achieve the objectives for which the contract was concluded. In order to avoid any doubt, this Article says so explicitly.

D. Co-operate actively and loyally

In a commercial agency, franchise and distribution contracts, and similar marketing relationship contracts, a party must do more than merely refrain from obstructing the other party's performance. In such contracts each party must collaborate actively and make a serious effort to achieve the objectives for which the contract was concluded. These objectives include, first of all, those that are common but may also include individual objectives.

However, a party is not under an obligation to act contrary to its own interests. In other words, the obligation to co-operate actively and loyally is meant to achieve win-win situations. Moreover, the obligation to co-operate loyally does not turn the contractual relationship into a fiduciary relationship in the sense of the law of trusts.

The obligation to co-operate implies an obligation for principals, franchisors and suppliers to treat their commercial agents, franchisees and distributors equally. Thus, the principal, the franchisor and the supplier must not discriminate against – i.e. make any unjustified distinction between – their commercial agents, franchisees and distributors, neither during the pre-contractual stage nor during the performance of the contract. Similarly, a commercial agent, a franchisee (e. g. in shop corner franchising) or a distributor, who has contracts with more than one principal, franchisor or supplier, must not make any unjustified distinction between them.

IV.E.–2:202: Information during the performance

During the period of the contractual relationship each party must provide the other in due time with all the information which the first party has and the second party needs in order to achieve the objectives of the contract.

COMMENTS

A. General idea

Each party must disclose all information in its possession to the other party if this is what the other party needs in order to achieve the objectives of the contract. This obligation includes an obligation to provide the other party with all relevant documentation where this is appropriate.

This general obligation is specified further in succeeding Chapters with respect to contracts for commercial agency, franchise and distribution.

B. Interests at stake and policy considerations

Both parties have an interest in being informed concerning facts and developments which are relevant to their performance. It may render their performance easier and more successful. On the other hand, an extensive obligation to inform the other party may be very burdensome and, in any event, very costly. Therefore, the present obligation is limited in two significant respects. First, a party only has to pass on to the other party such information as the first party already has. In other words, parties are not under a duty to investigate in order to be able to inform each other. Second, the obligation is limited to the information which the other party needs in order to achieve the objectives of the contract.

The obligation under this Article may be regarded as based on similar policy considerations as the duty to act in accordance with good faith and fair dealing in performing obligations. See III.-1:103 (Good faith and fair dealing) and Comment B to that Article: “In relationships which last over a period of time (*Dauerschuldverhältnisse*) such as ... agency and distributorship agreements ... the concept of good faith has particular significance as a guideline for the parties’ behaviour.” The obligation under this Article could also be regarded as a specific example of the particularly intense obligation to co-operate in marketing relationship contracts.

C. No duty to investigate

This obligation relates to actual knowledge. A party is only under the obligation to disclose the information which it actually has. A party is not under an obligation to make (possibly expensive) investigations in order to obtain the relevant information. In other words, if a party to a commercial agency, franchise or distribution contract, or similar marketing relationship contract comes across information which the other needs in order to achieve the objectives of the contract, it is under an obligation to pass that information on to the other party; it is not free to keep that information for itself.

D. In due time

The information must be given in due time in order to allow the other party to perform its obligations under the contract and, more generally, to achieve the objectives of the contract. When and how often information should be given depends, among other things, on the contract, the type of information and the other circumstances of the case. In the case of new developments, a party must, in principle, update the information which has been provided within a reasonable period of time in order to allow the other party to adapt to the new situation.

E. No form requirement

There is no general form requirement as to the way in which this information is to be provided. The aim of the Article is merely to oblige parties to communicate.

IV.E.-2:203: Confidentiality

(1) A party who receives confidential information from the other must keep such information confidential and must not disclose the information to third parties either during or after the period of the contractual relationship.

(2) A party who receives confidential information from the other must not use such information for purposes other than the objectives of the contract.

(3) Any information which a party already possessed or which has been disclosed to the general public, and any information which must necessarily be disclosed to customers as a result of the operation of the business is not regarded as confidential information for this purpose.

COMMENTS

A. General idea

Both parties to a commercial agency, distribution, franchise contract or other marketing relationship contract should treat any sensitive information they receive from the other party as confidential. This is especially true where key elements in the exploitation of the business (know-how, financial data et cetera) are disclosed, which often happens especially in franchise contracts. These are business values which are essential to the franchisor's (or supplier's) business concept and which must be kept within the network and saved from competitors.

However, not all information has to be considered as confidential: the information which a party already had or which was already publicly known when this party received it, and any information which is necessarily disclosed to customers when running the business is not to be treated as confidential.

B. Interests at stake and policy considerations

This rule protects the reasonable interest of a party (usually the franchisor, the principal or the supplier) and of the other members of the network in preventing its business method and other secrets from ending up in the hands of competitors.

The policy considerations behind the present rule are similar to those behind II. – 3:302 (Breach of confidentiality) which applies only to pre-contractual information received from the other party in the course of negotiations. They are also similar to those behind the general duty of good faith and fair dealing under III.–1:103 (Good faith and fair dealing) and the obligation to co-operate actively and loyally under IV.E.–2:201 (Co-operation).

C. Protection of know-how

In franchise contracts, throughout the duration of the contract, the franchisor must provide the franchisee with the know-how which is necessary to operate the franchise business (IV.E.–4:202). Moreover, in some other marketing relationship contracts, e.g. in certain specific types of distribution, a similar obligation may follow from the contract. Where one party is under such an obligation to share its know-how with the other, the obligation of confidentiality is of specific importance since it is the only way to guarantee that the know-how, as a value essential and intrinsic to the development of the franchisor's method of business, remains in the hands of the franchisor and does not benefit competitors.

D. Confidential information

What kind of information is confidential largely depends on the circumstances of the case. Such types of information may include product information, technology, market research, purchase price lists, customers' details et cetera. It is not a necessary requirement that the

information should be sophisticated or complex. Information known by the public can never be confidential.

Illustration 1

Franchisor A runs a franchise chain of travel agencies and provides its franchisees with know-how concerning the marketing of holidays to students. This knowledge is not generally known. Therefore, it is to be regarded as confidential information.

Illustration 2

Franchisor A runs a franchise network of travel agencies and provides its franchisees with know-how concerning a specific booking system. Within the travel business this booking system is used generally. Since this knowledge is generally known in this business, it is not to be regarded as confidential information.

E. Contractual and post-contractual

Confidential information is usually a business value which allows the successful exploitation of a business formula or commercialisation of the principal's, the franchisor's, or the distributor's products and which differentiates it from its competitors. If the information falls into the competitor's hands, it loses its value. Therefore, a party is required not to disclose the confidential information during, or after the termination, of the contractual relationship.

F. Information already public

All the information which a party already had in its possession, or which was already known to the public when the party received it, and any information which is necessarily disclosed to customers when properly running the business is not to be treated as confidential (Paragraph 3).

Section 3: Termination of contractual relationship

IV.E.-2:301: Contract for a definite period

(1) A party is free not to renew a contract for a definite period. If a party has given notice in due time that it wishes to renew the contract, the contract will be renewed for an indefinite period unless the other party gives that party notice, not later than a reasonable time before the expiry of the contract period, that it is not to be renewed.

(2) Where the obligations under a contract for a definite period continue to be performed by both parties after the contract period has expired, the contract becomes a contract for an indefinite period.

COMMENTS

A. General idea

This Article provides rules for two specific situations which can arise at or towards the end of a contract for a definite period, non-renewal and continued performance. The starting point, which does not need to be stated, is that the contractual relationship will come to an end on the expiry of the definite period.

Parties are free not to renew a contract for a definite period of time after the expiry of its term. However, if one party gives notice to the other in sufficient time that it wishes to renew the contract, the latter party, if it wishes not to renew the contract, has to respond not later than a reasonable time before the end of the contract period. If it fails to respond by that time, the contract will be renewed for an indefinite period.

A contract concluded for a definite period of time would normally end upon the expiry of the period. However, when the parties actually continue performing the contract after the agreed term has expired, an agreement that was concluded for a fixed term does not come to an end upon the expiry of the fixed term. Instead, the contract becomes a contract for an indefinite duration, subject to the same conditions.

B. Interests at stake and policy considerations

In principle, both parties have an interest in the binding force of their contract. In particular, it is in their interest to be certain that it will last for the period which they have agreed upon. It allows them to determine proper and rational business planning and to evaluate what investments they should make. However, during the course of the performance their interests may change. One party may wish to abandon the contract, e. g. because another contract is more favourable. If the other party agrees there is no problem (consensual ending of the contract) but the other party will usually object. In this rule the interest in legal certainty is upheld by guaranteeing the binding force of a contract for the term which the parties have agreed upon. If a party wishes to retain the right to end the contract at any time it should either provide for that in the contract or conclude a contract for an indefinite period (see IV.E.–2:302 (Contract for an indefinite period)).

The requirement to provide notice of non-renewal – when the other party has given sufficient notice that it wishes to renew the contract – even though a fixed duration for the contract was agreed upon, is based on the notion that, sometimes, the definite period may be very long and that the party giving notice of a wish to renew may build up hope that the contract will be renewed and will act accordingly. Therefore, a requirement of a counter-notice is not unreasonable. It is not an onerous requirement. The party intending not to renew does not have to give notice of non-renewal in any particular form. The only thing it has to do is to respond in such a way as to indicate that it does not wish to renew. Such a limited obligation to respond to a notice by the other party is not very burdensome and may be expected from a party under an intense general obligation to co-operate. The effect of not giving a timely counter-notice is that the contract will be renewed for an indefinite period. This does not, of course, mean that the parties are bound to each other forever. As in any contract for an indefinite period, either party has the right to unilaterally end the contractual relationship by giving notice (IV.E.–2:302 (Contract for an indefinite period)).

The idea underlying the rule contained in paragraph (2) is that parties have an “easy way out” at their disposal, which is the express term. It is presumed that if they do not decide to end the contract upon the expiry of such a term (they continue performing once the term expires or they expressly agree to prolong the relationship), it is because they are satisfied with the ongoing contractual relationship. Thus, there is a presumption which favours the continuation of the existing business relationship. A clear rule on continued performance is important in practice in order to avoid the situation where continuation may create legal uncertainty.

C. Definite period

Parties may have various reasons for concluding a contract for a definite period. One such reason is that the contract cannot be ended unilaterally during the period which the parties have agreed upon. Another reason may be the applicability of other rules. For example, “non-compete obligations” benefit from the block-exemption, and are therefore presumed to be valid from an EC competition law perspective, if they do not exceed a period of five years (EC Regulation 2790/1999, Article 5(a)). As a result, many distribution and franchise contracts are concluded for a period of five years.

D. Notice of renewal and response to non-renewal

A proposal for renewal and a notice by the other party of its decision not to renew may be given by any means appropriate in the circumstances and becomes effective when it reaches the addressee (II. – 1:106 (Notice) paragraphs (1) and (3)).

A notice by a party who wishes to renew the contract must be given in due time; the responding notice by the other party of its decision not to renew must be given within a reasonable time before the expiry of the contract. What constitutes due time and a reasonable time respectively depends on the circumstances of the case. Obviously, the second period depends, in part, on the first.

F. Continued performance: a new contract for an indefinite period subject to the old conditions

In the case of continued performance the contract becomes a contract for an indefinite period. But on what conditions? In most cases the same basic obligations on the part of the parties will continue, unless the way in which the parties continue to perform the obligations under the contract shows otherwise. Other (ancillary) obligations, the prolongation of which is no longer appropriate, may be dispensed with at the time of the expiry of the term. Ultimately, this is a matter of interpretation to be determined by the court.

Obviously, as a result of continued performance the parties are not bound to each other forever. As in any contract for an indefinite period, either party has the right to unilaterally end the contractual relationship by giving notice (IV.E.–2:302 (Contract for an indefinite period)).

IV.E.–2:302: Contract for an indefinite period

(1) Either party to a contract for an indefinite period may terminate the contractual relationship by giving notice to the other.

(2) If the notice provides for termination after a period of reasonable length no damages are payable under IV.E.–2:303 (Damages for termination with inadequate notice). If the notice provides for immediate termination or termination after a period which is not of reasonable length damages are payable under that Article.

(3) Whether a period of notice is of reasonable length depends, among other factors, on:

- (a) the time the contractual relationship has lasted;*
- (b) reasonable investments made;*
- (c) the time it will take to find a reasonable alternative; and*
- (d) usages.*

(4) A period of notice of one month for each year during which the contractual relationship has lasted, with a maximum of 36 months, is presumed to be reasonable.

(5) The period of notice for the principal, the franchisor or the supplier is to be no shorter than one month for the first year, two months for the second, three months for the third, four months for the fourth, five months for the fifth and six months for the sixth and subsequent years during which the contractual relationship has lasted. Parties may not exclude the application of this provision or derogate from or vary its effects.

(6) Agreements on longer periods than those laid down in paragraphs (4) and (5) are valid provided that the agreed period to be observed by the principal, franchisor or supplier is no shorter than that to be observed by the commercial agent, the franchisee or the distributor.

(7) In relation to contracts within the scope of this Part, the rules in this Article replace those in paragraph (2) of III.–1:109 (Variation or termination by notice). Paragraph (3) of that Article governs the effects of termination.

COMMENTS

A. General idea

A contract is for an indefinite period either when it does not contain any specific duration or when it explicitly states that it is for an indefinite period. The present rule provides that in either case the contractual relationship can be terminated unilaterally by giving notice. In other words, each party has ‘a right to end’ the relationship. A reasonable period of notice is not a requirement for the effective termination of the relationship. However, if the period of notice is not reasonable compensation is payable under the following Article.

Paragraph (3) gives guidance to the parties and the courts in establishing what would be a reasonable period of notice in the circumstances of a particular case. Although the list indicates the factors which are most likely to be of relevance, it is not meant to be exhaustive: depending on the circumstances of the case other factors may be relevant for establishing what period of notice will be reasonable. This Article is based on the assumption that it is impossible to indicate only one or two factors which will be decisive in all cases. The possible uncertainty with regard to the relative weight of each of the factors is mitigated by the presumption indicated in paragraph (4).

For a principal, a franchisor or a supplier who wants to end the contractual relationship there is a minimum period of notice: one month for the first year, two months for the second, three months for the third, four months for the fourth, five months for the fifth and six months for the sixth and subsequent years. This is a mandatory rule; parties may not derogate from this provision (paragraph (5)).

Of course, the parties are free to agree on longer periods of notice than the ones provided for in paragraphs (4) and (5). However, if they do so the agreed period to be observed by the principal, franchisor or supplier may not be shorter than the one to be observed by the commercial agent, the franchisee or the distributor (paragraph (6)).

Paragraph (7) clarifies the relationship with the general rules on termination by notice in Book III. The provisions of the present Article on reasonable periods replace the provisions in III.–

1:109 (Variation or termination by notice) but the general provisions in paragraph (3) of that Article govern the restitutionary and other effects of termination.

B. Interests at stake and policy considerations

On the one hand, there is the interest of the party who wishes to end the relationship which under the contract is to last for an indefinite period. It may wish to do so for various reasons. For example, it may wish to end its activity in this particular geographical area, or it may have found another agent, franchisee or distributor whom it expects to be more effective. In all these cases, without this provision the party who no longer wishes to continue the contractual relationship would nevertheless be linked to the other until the end of time, unless the other party agrees to a termination.

On the other hand, the other party usually has no interest in the ending of the relationship. On the contrary, especially when the performance of the obligations under this contract is its main activity, the contract may be the very basis of its economic existence. Moreover, this party may have made important investments which will only see a return after a period of many years. Also, it may be very difficult for this party to find an equally satisfactory alternative. Therefore, this party may be economically very dependant on the continuation of the contractual relationship.

In this rule these interests are balanced in the following way. A party who wishes to terminate a contractual relationship for an indefinite period will succeed: the notice of termination will be effective. However, the other party's interest in continuing the contractual relationship for a reasonable period is protected, albeit in a monetary way. A party who terminates the relationship without giving reasonable notice will be liable to compensate the other for the loss sustained by not getting a reasonable notice (see IV.E.-2:303 (Damages for termination with inadequate notice)).

This rule not only balances the interests of the parties; it is also in the general interest. First, by establishing that a party has a right to terminate unilaterally it provides legal certainty which diminishes litigation. Secondly, it is economically efficient: if a party (e. g. a franchisor) can derive a greater benefit from a contract with another party (e. g. a new franchisee) than it costs to perform the new contract *and* to properly compensate the aggrieved party (the first franchisee), then termination creates a surplus, since at least one party is better off without anyone being worse off.

The period of notice (and the compensation in lieu of this) is meant to safeguard the interests of the party confronted with unilateral termination by its counterpart. Therefore, the factors mentioned in paragraph (3) mainly focus on that party's position. However, this does not mean that in establishing what notice period would be reasonable in the circumstances, only the interests of the aggrieved party should be taken into account. Not only can the facts of the case relating to each of the factors point to a shorter period of notice (e. g. the absence of investments by the aggrieved party, of a post-contractual competition clause, of difficulties in finding an alternative etc.), but also in the case of facts which point towards a longer period, these factors must be weighed against the interest of the party which wishes to end the relationship.

C. Relation to other provisions

The rules in this Article replace the rule contained in III.–1:109 (Variation or termination by notice) paragraph (2). The scheme is different. Under III.–1:109(2) a reasonable period is a requirement for effective termination. Under the present Article a reasonable period is a requirement only for the avoidance of liability for compensation. The default rules on what is a reasonable period also differ. However, the rules in III.–1:109 (Variation or termination by notice) paragraph (3) on the effects of termination do apply for the purposes of the present Article. That means that where the parties do not regulate the effects of termination, then:

- (a) it has prospective effect only and does not affect any right to damages, or a stipulated payment, for non-performance of any obligation performance of which was due before termination;
- (b) it does not affect any provision for the settlement of disputes or any other provision which is to operate even after termination; and
- (c) in the case of a contractual obligation or relationship any restitutionary effects are regulated by the rules in Chapter 3, Section 5, Sub-section 4 (Restitution) with appropriate adaptations.

The general provisions on notice in II.–1:106 (Notice) apply. So notice may be given by any means appropriate in the circumstances (paragraph (2)) and becomes effective when it reaches the addressee (paragraph (3)).

D. No “good reason” required for terminating the relationship

This rule does not subject a party’s right to end the relationship to an evaluation of the appropriateness of its reasons. Even where the party who gives notice has no good reason the notice is nevertheless effective.

E. Reasonableness of the period of notice

In assessing what is reasonable, the nature and purpose of the contract, the circumstances of the case and the usage and practices of the trade or profession involved should be taken into account.

The list in paragraph (3) of specific factors which may play a role in assessing whether a reasonable period of notice was provided, is not meant to be exhaustive. This means that other factors may also determine what period of notice is reasonable in the circumstances. Conversely, not all these factors play a role in each case. Moreover, not all factors have the same weight in each case. All this remains a matter for the court to consider.

The time the contractual relationship has lasted. In most cases the period during which the contract has lasted will be an important factor. Normally, the longer the contractual relationship has lasted the more a party becomes dependent on it and the more difficult it will be to adapt to a new situation and, as a consequence, the greater its damage in the case of unilateral termination by the other party.

The importance of this factor is reflected in the fact that the minimum notice period for the principal, the franchisor or the supplier in paragraph (5) increases with each year during which the contractual relationship has lasted.

However, although in most cases the assumption is that the longer the relationship has lasted the longer the notice period must be, this factor may, in certain circumstances, also point in the opposite direction. If the contractual relationship has lasted for a long time, in some cases this may have been sufficient for the parties to fully recover their investments. Therefore, this factor may also point to a shorter period of notice.

Reasonable investments made. Frequently, unilateral termination will occur at a moment when a party has not yet seen a return on all the investments which it has made for the purposes of the contract. Unless it is protected by a rather long period of notice which allows it to amortise its investments (or compensated by damages in lieu thereof) it may be confronted with extensive losses. Conversely, if the aggrieved party has not made any important investments this may be a reason to accept a rather short notice period. Therefore, the investments made by the aggrieved party will usually play an important role in assessing the length of a reasonable notice period.

However, not all investments made by the aggrieved party should be taken into account, but only those investments which were reasonable in the circumstances; excessive investments are at a party's own risk. Moreover, in principle only specific investments should be taken into account. General investments, for example investments in a generic showroom which can be sold or let or sublet should in principle not be taken into account.

On the other hand, however, recovery is not limited to investments induced or even requested by the other party. In principle, all reasonable investments may be taken into account.

In principle, in the present system there is no room for complementary damages (i.e. in addition to damages in lieu of the notice period) for the recovery of damages due to useless investments not fully amortised by the notice period, as some European systems are familiar with. Under the present system, such investments are always covered by the notice period (and the damages in lieu thereof). This may in some cases lead to a very long period of notice of more than one year being required if liability for damages is to be avoided.

Within this system, however, there is a possibility that the aggrieved party will be additionally entitled to a goodwill indemnity in accordance with IV.E.-2:305 (Indemnity for goodwill).

The time it will take to find a reasonable alternative. An important function of the period of notice is to allow the aggrieved party to adapt to the new situation, especially to find an alternative, either a new principal, franchisor or supplier, or to commence a different economic activity. The easier it is for this party to find an acceptable alternative, the shorter the period of notice can be. What counts is a reasonable alternative: it does not necessarily have to provide the same benefits or be exactly in the same trading sector or in the same place.

Here post-contractual non-competition clauses may be of relevance. If the contract contains a valid clause which restrains post-contractual competition, it may be more difficult for the aggrieved party to find an alternative. Consequently, in such a case the reasonable period of notice should in principle be longer. However, to the extent that the aggrieved party's difficulty in finding an alternative economic activity has already been compensated by the compensation which is due under the contract or under the law relating to post-contractual

non-competition clauses, that difficulty should again be taken into account here. Consequently, the reasonable notice period may be shorter (and the damages in lieu thereof lower).

Usages. Obviously, the reasonableness of the notice period may vary according to the type of contract (commercial agency, franchise, distribution) and the sector of the trade (e.g. within distribution: beer, cars, petrol). Especially the presence of usages in a particular trade may be of relevance in establishing the reasonableness of a notice. Such usages may sometimes be inferred from codes of conduct, although much depends on the persons and organisations involved in drafting these codes (e.g. only franchisors).

However, on the other hand, there is no presumption that periods of notice will be generally longer for one type of contract than for another, as is the case in some European jurisdictions. On the contrary, the minimum notice periods for the principal, the supplier and the franchisor provided for in paragraph (5) are the same for all contracts concerned.

More generally, although usages may play a role in determining what is reasonable, they will not supersede the reasonableness test. In other words: any unreasonable usage (which may be the result of a monopoly or oligopoly leading to structurally unequal bargaining power) should be disregarded, unless the parties have explicitly agreed otherwise.

F. Presumption of reasonableness

Paragraph (4) contains a presumption that a notice period of one month for each year during which the contractual relationship has lasted, with a maximum of 36 months, is reasonable.

This presumption is rebuttable. The aggrieved party may prove that the presumably reasonable period (including the maximum of three years) is unreasonably short in the circumstances. Conversely, the party which has ended the relationship may prove that the presumed period is unreasonably long.

G. Minimum period

For the principal, the franchisor or the supplier who wishes to end the contractual relationship there is a minimum period of notice (see paragraph (5)): the period is to be no less than one month for the first year, two months for the second, three months for the third, four months for the fourth, five months for the fifth and six months for the sixth and subsequent years during which the contract has lasted. Parties may not derogate from this provision.

H. Agreed longer periods

If the parties agree on longer notice periods than those laid down in paragraphs (3) and (4) then the agreed period to be observed by the principal, franchisor or supplier must be no shorter than that to be observed by the commercial agent, the franchisee or the distributor. In other words, the parties are free to agree on longer notice periods than the ones which are considered to be reasonable. However, they may not do so exclusively for the benefit of the principal, franchisor or supplier. To the extent that they nevertheless do so, such an agreement is invalid.

I. Character of the rule

This is a default rule; the parties are free to agree otherwise. However, the minimum period of notice contained in paragraph (5) is mandatory; any agreement on a shorter period by the

parties remains without effect. Moreover, paragraph (6) is also mandatory: the parties may not derogate from this provision.

IV.E.–2:303: Damages for termination with inadequate notice

(1) Where a party terminates a contractual relationship under IV.E.–2:302 (Contract for indefinite period) but does not give a reasonable period of notice the other party is entitled to damages.

(2) The general measure of damages is such sum as corresponds to the benefit which the other party would have obtained during the extra period for which the relationship would have lasted if a reasonable period of notice had been given.

(3) The yearly benefit is presumed to be equal to the average benefit which the aggrieved party has obtained from the contract during the previous 3 years or, if the contractual relationship has lasted for a shorter period, during that period.

(4) The general rules on damages for non-performance in Book III, Chapter 3, Section 7 apply with any appropriate adaptations.

COMMENTS

A. General idea

Under the preceding Article a party can terminate a contractual relationship which is to last for an indefinite time by giving notice. No period of notice is required for the termination to take effect. However, if a reasonable period of notice is not given the other party is entitled to damages. This Article regulates that question.

The aggrieved party's compensatable damage amounts to the expectation interest (paragraph (2)): it should be placed, as far as possible, in the position in which it would have been if a notice of reasonable length had been provided. If reasonable notice had been given the aggrieved party would have had all the usual benefits from the contract during the remainder of its duration (i.e. the reasonable notice period). Therefore, the aggrieved party is, in principle, entitled to compensation for the loss of that benefit.

Paragraph (3) contains a presumption that the yearly benefit is equal to the average benefit which the aggrieved party has received from the contract during the last three years. The idea is to refer to a period of time which is indicative of the business of the aggrieved party. Exceptional circumstances should not be taken as a general measure.

Finally, although, strictly speaking, these are not damages for non-performance of an obligation (the notice ends the contract, even if the period of notice was too short) but rather for not giving a reasonable period of notice, the application of the normal regime on damages for non-performance of an obligation is appropriate here. Therefore, paragraph (4) declares that these rules apply with any necessary adaptations.

B. Interests at stake and policy considerations

The rule that damages are the only remedy is based on considerations of economic efficiency: as long as a party is ready to pay (damages), it should be capable of ending the contract

without observing a period of notice. Compelling it to ‘wait’ until a reasonable period of time has expired, could result in the loss of other opportunities. Therefore, the system adopted here provides the most efficient solution: a party can effectively end a contract, but will have to pay a ‘price’ (compensation). If the ‘price’ is lower than the benefit it expects from ending the contract, at least one party is better off without anyone else being actually worse off.

The ‘price’ to be paid amounts to full compensation of the interest the aggrieved party had in the observance of the notice period, i.e. all the benefits it would have derived from the contract during the (remainder of) the period of notice. In other words, the expectation interest.

C. Damages the only remedy

Unlike in the ordinary case of non-performance of an obligation, here the aggrieved party (in principle) has only one remedy: damages. There is no obligation to give a reasonable period of notice (and therefore no question of specific performance) but just a requirement to give it if a claim for damages under the present Article is to be avoided. It would be inappropriate to impose an obligation (rather than set out a simple requirement) and to allow specific performance.

The present system provides the parties with the certainty that the notice will effectively end their contractual relationship.

D. Calculation of damages

The general test for the amount of damages is the benefit which the aggrieved party would have obtained during the non-observed period of notice (the expectation interest).

What is meant here is the ‘net’ benefit: if the aggrieved party during that period has to (continue to) incur expenses which cannot be (immediately) avoided (e. g., depending on national labour law, laying off personnel which the aggrieved party cannot reasonably employ in another function or elsewhere), then these will also have to be compensated.

The estimation of benefit is based on the benefit which the aggrieved party has obtained from the contract during the previous 3 years. However, other factors may be taken into account, either in order to raise or to mitigate the amount. One such factor may be the aggrieved party’s right to transfer its contractual position to a third party. If it can ‘sell its business’ to a successor, the benefit from this transfer will be taken into account.

E. Concrete damages

Damages are not calculated in an abstract fashion: what must be compensated is the damage which has been (or will be) effectively suffered by the aggrieved party.

Therefore, although damages should amount to the benefit which the aggrieved party would have obtained during the non-observed period of notice, and although the estimation of the benefit is based, in principle, on the average benefit which the aggrieved party has obtained from the contract during the previous 3 years, liability ultimately depends on the damage which the aggrieved party actually suffers.

Illustration 1

A distributor runs a petrol station. The petrol supplier ends the relationship after four years by giving one month's notice of termination. According to the preceding Article the supplier ought to have given at least four months' notice, which is considered reasonable in this case. To run the petrol station the distributor employs four persons. To make them redundant the distributor must itself observe a notice period of five months. In other words, the distributor must pay their salaries for another five months. The damages which the supplier must pay are 3/12 of the average benefit of the last three years and the sum resulting from the salary costs of the four persons for the forthcoming five months.

F. General rules on damages applicable

The general rules on damages for non-performance apply here as well. They include e. g. rules on foreseeability, loss attributable to the aggrieved party, reduction of loss, and substitute transactions .

IV.E.-2:304: Termination for non-performance

(1) Any term of a contract within the scope of this Part whereby a party may terminate the contractual relationship for non-performance which is not fundamental is without effect.

(2) The parties may not exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The normal rule is that the parties can provide for termination on any ground they wish. See III. – 1:109 (Variation or termination by notice) paragraph (1). Normally therefore they are free to provide that even a minor non-performance of any obligation under the contract will entitle the other party to terminate the relationship. If they have no such provision then only a fundamental non-performance will justify termination (III.-3:502 (Termination for fundamental non-performance)). The list of definitions in Annex 1 provides that:

A non-performance of a contractual obligation is fundamental if (a) it substantially deprives the creditor of what the creditor was entitled to expect under the contract, as applied to the whole or relevant part of the performance, unless at the time of conclusion of the contract the debtor did not foresee and could not reasonably be expected to have foreseen that result or (b) it is intentional or reckless and gives the creditor reason to believe that the debtor's future performance cannot be relied on.

The general idea of the present Article is that, in the case of non-performance of the obligations under a commercial agency, franchise or distribution contract, or similar marketing relationship contract, the contractual relationship may be terminated for non-performance *only* when the non-performance is fundamental.

The normal freedom to stipulate for a right to terminate for any non-performance of an obligation however minor is not appropriate to contracts where parties sometimes make considerable investments in long-term relationships, and where they are frequently dependent on the continuity of such a relationship. Such a relationship may not be terminated by one party on account of the other party's mere non-performance of an obligation unless the non-performance is fundamental as defined above.

Therefore, these long-term commercial relationships may be terminated for non-performance if indeed (i) the non-performance is intentional or reckless and gives the aggrieved party reason to believe that it cannot rely on the other party's future performance, or (ii) the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract.

Illustration 1

An international chain of hamburger restaurants provides its franchisees with a book containing hundreds of pages and thousands of very detailed instructions relating to all aspects of hamburger selling. The franchise contract says that strict compliance with each of these instructions is of the essence of the contract. During a monthly inspection the franchisor discovers that hamburgers in one particular restaurant are on average 2% too hot. The franchisor may not terminate the franchise.

B. Interests at stake and policy considerations

Although the aggrieved party may have a considerable interest in strict compliance with the contract, e.g. because it needs to maintain the good reputation of the product or the trademark (in the case of a principal, a franchisor or a supplier) or because it risks running out of stock (in the case of the commercial agent, the franchisee or the distributor), the other party usually has an equally (or even more) important interest in the continuity of the contractual relationship.

Therefore, the aggrieved party is only allowed to terminate the contractual relationship where the non-performance is intentional or reckless and therefore undermines the relationship or it deprives the aggrieved party of most of the benefit under the contract.

However, if the contract is for an indefinite period either party may always terminate the relationship by giving notice under IV.E.-2:302 (Contract for an indefinite period). Unless it gives reasonable notice the party who wishes to end the contract will have to pay damages to the other party (IV.E.-2:303 (Damages for inadequate notice)).

C. Character of the rule

This rule is mandatory: the parties cannot exclude it by contract. (see paragraph 2).

IV.E.-2:305: Indemnity for goodwill

(1) When the contractual relationship comes to an end for any reason (including termination by either party for fundamental non-performance), a party is entitled to an indemnity from the other party for goodwill if and to the extent that:

(a) the first party has significantly increased the other party's volume of business and the other party continues to derive substantial benefits from that business; and

(b) the payment of the indemnity is reasonable.

(2) The grant of an indemnity does not prevent a party from seeking damages under IV.E.–2:303 (Damages for termination with inadequate notice).

COMMENTS

A. General idea

Irrespective of whether the contract was for an indefinite or a definite period and irrespective of the way in which the contract ended (whether or not for fundamental non-performance), the mere fact that the contractual relationship comes to an end may lead to a transfer of goodwill. To the extent that such a transfer has actually taken place and indemnification would be reasonable in the circumstances there is a ground for the payment of an indemnity. This Article provides the other party with a remedy.

Goodwill has its own value which must be differentiated from the expectation interest under the contract. Therefore, it should always be refunded irrespective of the way the contractual relationship is ended. Indemnity for the clientele does not depend on any sort of fault. It will cumulate with damages in the case of the premature termination of the relationship without adequate notice (see IV.E.–2:303 (Damages for termination with inadequate notice)).

B. Interests at stake and policy considerations

The entitlement to an indemnity for transfer of goodwill is based on considerations similar to those underlying the law on unjustified enrichment: a party should not be unjustifiably enriched as the result of the termination of a long-term commercial relationship.

C. Generated goodwill

A party which claims an indemnity for the transfer of goodwill has to prove that it has significantly increased the other party's volume of business. In other words, it must prove that the goodwill it had was transferred to the other party as a result of the termination of the contractual relationship. It is crucial that the agent, franchisee or distributor has played an active role in increasing the volume of business of the other party. This means that where the volume has increased as a consequence of a new client from a party's exclusive territory, this party is not automatically entitled to an indemnity.

The most typical example of transfer of goodwill is where the principal, franchisor or supplier has access to lists of clients and other similar data either because the commercial agent, franchisee or distributor has handed such lists over after the termination of the relationship or because the principal, franchisor or supplier otherwise has access to such data (e. g. because the commercial agent, franchisee or distributor has regularly passed such information on to the principal, franchisor or supplier during the relationship).

D. Commercial agency, franchise and distributorship distinguished

In the case of commercial agency contracts the termination of the agency will normally lead to a transfer of goodwill. Therefore, frequently there will be a right to compensation. On the other hand, in the case of franchise the goodwill is rarely the goodwill of the franchisee since, typically, clients are attracted by the image of the brand and the network. In the case of distributorships, sometimes the goodwill (clientele) will be attracted by the supplier's products or its brand (especially in the case of exclusive distribution agreements). However, it

may also be the distributor who, like an agent, has created the market for the products. In the latter case, the distributor may be entitled to goodwill compensation after the ending of the relationship.

E. Continuous substantial benefits

The party claiming an indemnity must prove that the generated goodwill stays with the other party and that it is substantial. Normally, the benefits which the other party continues to derive decrease gradually over time. This must be taken into account. Moreover, the general turnover of this specific principal, franchisor or supplier may decrease in time, e. g. because the general market for its products deteriorates. Such a development should also be taken into account. However, the principal, franchisor or supplier is presumed to continue to derive substantial benefits from the generated goodwill even if it sells its business or client list to a third party if it can be shown that the purchaser will use the client base.

F. Reasonable indemnity

A party who claims an indemnity for the transfer of goodwill also has to prove that the indemnity it claims is reasonable in the circumstances. Annex 1 provides that “What is ‘reasonable’ is to be objectively ascertained, having regard to the nature and purpose of what is being done, to the circumstances of the case and to any relevant usages and practices.” Obviously, the reasonableness test leaves some room for interpretation.

For commercial agency, Chapter 2 provides a specific rule on how to calculate goodwill compensation. (IV.E.–3:312).

G. Relation to damages for irregular termination

The grant of an indemnity for goodwill does not prevent a party from seeking damages. In other words, damages for termination with inadequate notice and an indemnity for goodwill can, in principle, cumulate.

However, when establishing whether an indemnity for goodwill is reasonable in the circumstances the entitlement of the aggrieved party to damages for irregular termination should be taken into account. In other words, the same loss cannot be compensated twice, once as loss of benefit (damages amounting to the expectation interest) and once as ‘loss’ of goodwill (indemnity for the transfer of goodwill).

H. Relation to compensation for post-contractual non-competition

If a party, as a result of a valid post-contractual non-competition clause, is not allowed to compete with its former principal, franchisor or supplier, and if, as a result clients who would have moved to it had it started a competing activity now move to its former principal or franchisor or supplier, the combined effect of termination and the post-contractual non-competition clause may be a transfer of goodwill in the sense of this Article, which gives rise to a right to be indemnified. However, if the impossibility to compete is already compensated by an entitlement for the commercial agent, franchisee or distributor to compensation (compensation for post-contractual non-competition), as will usually be the case, then the commercial agent, franchisee or distributor is not impoverished, and is therefore not entitled to an indemnity for goodwill.

I. Relation to post-agency commission

Under certain circumstances the agent is entitled to commission for contracts concluded by the principal after the agency has ended. If a claim for a goodwill indemnity under the present Article is considered, the entitlement to such commission must be taken into account in two ways. First, if such entitlement exists no indemnity is due for the transfer of the same clientele. Secondly, the fact that no entitlement is due is an indication that no transfer of goodwill has taken place, and that therefore the agent is not entitled to goodwill compensation. In sum, it is very unlikely that a claim by an agent for goodwill compensation under this Article will succeed.

IV.E.–2:306: Stock, spare parts and materials

If the contract is avoided, or the contractual relationship terminated, by either party, the party whose products are being brought on to the market must repurchase the other party's remaining stock, spare parts and materials at a reasonable price, unless the other party can reasonably resell them.

COMMENTS

A. General idea

These Comments will refer to commercial agents, franchisees and distributors and their counterparts but the same comments apply to parties to other contracts within the scope of this Part.

If a commercial agent, franchisee or distributor is left with excess stock, spare parts and advertising and other materials after the contract has been avoided or the contractual relationship terminated, the principal, franchisor or supplier must repurchase those objects, and it must do so at a reasonable price. However, if the agent, franchisee or distributor can itself reasonably resell them, the principal, franchisor or supplier is under no obligation to repurchase them and to incur useless transaction and transportation costs.

This rule is normally more relevant to distribution and franchise relationships than to commercial agency, since in the latter no property normally passes. However, where the agent has actually bought advertisement materials or spare parts or other objects from the principal this rule will also protect the agent.

B. Interests at stake and policy considerations

After the premature termination of the contractual relationship, the commercial agent, franchisee or distributor will frequently be left with excess stock, spare parts and materials which will usually no longer be of any value to it. With the termination the agent, franchisee or distributor may even have lost the right to use or resell them (especially in the case of a valid post-contractual non-competition clause). On the other hand, the excess stock, spare parts and materials will normally still be useful to the principal, franchisor or supplier which can either use them itself or sell them to the new or other agents, franchisees or distributors. Therefore, the principal, franchisor or supplier must repurchase them.

As a result of the termination of the contractual relationship the agent, distributor, or franchisee finds itself in a weak bargaining position. Therefore, this Article provides that the principal, franchisor or supplier must pay a reasonable price.

However, an obligation to repurchase stock, spare parts and materials would be inefficient where the agent, franchisee or distributor can itself reasonably resell them. Therefore, in those cases no such obligation exists.

C. Reasonable price

In many cases a reasonable price will be the price for which the principal, supplier or franchisor can resell the objects in question to the new or other agents, franchisees or distributors. For very old stock this may mean that the price is very low. Another circumstance which may be relevant to establish whether it is a reasonable price, is whether minimum obligations to buy were imposed unilaterally by the principal, franchisor or supplier on the commercial agent, franchisee or distributor.

In principle, it should be practically impossible for the commercial agent, franchisee or distributor to speculate with regard to the price to be paid by the principal, supplier or franchisor by buying unusually large amounts, since normally the commercial agent, franchisee or distributor will only hear of the principal's, supplier's or franchisor's intention to terminate the relationship when the notice is given. However, should it be established that the agent, franchisee or distributor has nevertheless bought unusually large amounts on a falling market, successful speculation should be avoided by taking this fact into account when establishing what amounts to a reasonable price in the circumstances.

Illustration 1

A distributorship for ready to wear designer clothes has been terminated. The distributor still has some clothes in stock from the collections of the present and the previous year. The price which the supplier must pay the distributor, differs from collection to collection. A reasonable price for the collection of the present year probably corresponds to the price which the distributor paid. However, the price which the supplier must pay for the collection of the previous year is probably considerably lower.

D. No obligation to repurchase

There is no obligation for the principal, supplier or franchisor to repurchase stock, spare parts and materials when the agent, franchisee or distributor can itself reasonably resell them. The burden of proof is on the principal, supplier or franchisor. 'Reasonably' means without great effort, for a reasonable price and within a reasonable time.

E. Relation to the period of notice

To the extent that the principal, franchisor or supplier has given the commercial agent, franchisee or distributor, the opportunity (and, where necessary, the right) to use up its remaining stock, spare parts and materials or to resell them to the public or to the new or other agents, franchisees or distributors, the former is not under an obligation to repurchase them.

Section 4: Other general provisions

IV.E.–2:401: Right of retention

In order to secure its rights to remuneration, compensation, damages and indemnity the party who is bringing the products on to the market has a right of retention over the movables of the other party which are in its possession as a result of the contract, until the other party has performed its obligations.

COMMENTS

A. General idea

These Comments will refer to commercial agents, franchisees and distributors and their counterparts but the same comments apply to parties to other contracts within the scope of this Part.

As a result of this Article the commercial agent, franchisee or distributor is entitled to refuse to give movables which are owned by the principal, franchisor or supplier back to the principal, franchisor or supplier (or, as the case may be, to the new owner) as long as the principal, franchisor or supplier has not fully paid the remuneration, compensation, damages, and indemnity to which the commercial agent, franchisee or distributor is entitled. This right is of special significance as a means to exercise pressure on the former principal, franchisor or supplier after the contract has expired or has been terminated or ended.

The right of retention is effective not only towards the (former) principal, franchisor or supplier but also towards third parties (e. g. the new owner of the goods).

This rule is normally more relevant to commercial agency relationships, in which normally no property passes, than to franchise and distribution relationships. Nevertheless, where appropriate, this rule may also protect the claims of franchisees and distributors.

B. Interests at stake and policy considerations

This rule intends to protect the interests of the commercial agent, franchisee or distributor when its money claims towards its (former) principal, franchisor or supplier remain unpaid. This Article provides it with some security.

C. Relation to other provisions

The right of retention will be dealt with in Book IX (Proprietary Security Rights in Movable Assets). The right of retention will usually be also a right to withhold performance in the sense of III.–3:401 (Right to withhold performance of reciprocal obligation). That is the case whenever the commercial agent, franchisee or distributor is under a contractual obligation to return the goods it retains. However, contrary to the right to withhold performance, the right of retention is also effective towards third parties.

D. Right of retention

All the ordinary rules relating to the right of retention apply. This means, among other things, that such a right is also effective vis-à-vis third parties. See further Book IX (Proprietary Security Rights in Movable Assets).

IV.E.–2:402: Signed document available on request

(1) Each party is entitled to receive from the other, on request, a signed statement in textual form on a durable medium setting out the terms of the contract.

(2) The parties may not exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The function of this Article is twofold: (i) providing the requesting party with information and (ii) facilitating evidence. It does not, however, introduce any formal requirement for the validity of the contract.

B. Interests at stake and policy considerations

Especially in the case of a dispute, the parties will usually need a statement in textual form on a durable medium on which to rely for evidence. In most cases the obligation will not be very burdensome: some textual record of what was agreed upon usually exists. However, it should be kept in mind that this record can be requested either at the conclusion of the contract or during the performance of the obligations under it and even within a reasonable time after the contractual relationship has ended. Therefore, a party must keep a record even some time after the end of the relationship.

C. Terms of the contract

The signed document that a party may request must set out the terms of the contract. This means that if a document is requested after changes have been made to the initial contract, the party requesting the document is entitled to the most recent version of the terms of the contract and not only to the initial one.

D. Signed statement in textual form on a durable medium

The meanings of “signed”, “in textual form” and “on a durable medium” are given in I.–1:105 (Meaning of “in writing” and similar expressions) and [I.–1@106](#) (Meaning of “signature” and similar expressions). See also the Comments on those Articles.

E. Character of the rule

This rule is mandatory; any deviation from it by the parties to the detriment of the party who would benefit from it remains without effect.

CHAPTER 3: COMMERCIAL AGENCY

Section 1: General

IV.E.–3:101: Scope

This Chapter applies to contracts under which one party, the commercial agent, agrees to act on a continuing basis as a self-employed intermediary to negotiate or to conclude contracts on behalf of another party, the principal, and the principal agrees to remunerate the agent for those activities.

COMMENTS

A. General idea

The commercial agent's main task consists of prospecting the market, attracting customers, promoting the sale or purchase of products and negotiating the terms of contracts which will be concluded between the principal and the customer or seller. The agent may also be entrusted with concluding contracts for the principal. The commercial agent always acts independently of and on behalf of the principal. A commercial agency agreement may be concluded for a definite or indefinite period of time.

The principal must remunerate the commercial agent (Section 3). If the parties have stipulated that the agent will not be remunerated, this Chapter applies by way of analogy where appropriate.

A principal who wants to be active in a certain area may conclude a contract with a commercial agent in order to find out whether specific products will be successful in a certain territory or with a certain group of customers. The agent will do all the preparatory work, which enables the principal to conclude contracts more easily, namely without making high investments and running high risks.

The agent may, as a self-employed intermediary, organise its activities as it thinks fit. Although the agent must comply with reasonable instructions given by the principal (IV.E.–3:202 (Instructions)), the latter cannot affect the agent's independence.

The relevance of this Article is that it determines whether a certain contractual relationship may be qualified as a commercial agency and, thus, whether the Articles in this Chapter are applicable. This is of special interest in relation to the mandatory rules in several of the Articles.

B. Self-employed intermediary

The concept of a self-employed intermediary is taken from the Directive. Self-employed refers to the fact that the agent in any case acts independently from the principal, that is to say that the commercial agent is not its employee. A commercial agent may be either a legal entity or a natural person. These rules may in principle apply to commission agents. The concept of intermediary is introduced in order to clarify that the activity of the agent must lead to the conclusion of contracts between two other parties, i. e. the principal and the customer or seller.

Illustration 1

A produces and sells perfume. A enters into a contract with B, according to which B will negotiate contracts of sale with respect to the perfume on A's behalf and on A's

account. In the contract it is stipulated that A determines B's working hours. In such a situation B is not a self-employed intermediary.

C. Contracts with customers

The purpose of the agency agreement is that the agent negotiates (and possibly concludes) contracts on behalf of (and in the name of) the principal. Although it is most common that commercial agents are appointed for the sale or purchase of goods, in exceptional cases they may be concerned with the promotion of services. This Chapter applies in both situations. In this Chapter the resulting contract, i. e. the one to be concluded by the principal or in the principal's name, will be referred to as the contract with the customer, the customer being the party (the reseller or service provider) who enters into a contract with the principal.

D. Competition law

Competition law may exceptionally affect the validity of some agency agreements. The European Commission has declared Article 81 (1) EC to be applicable to agency relationships whereby the agent bears important financial and commercial risks in relation to the activities for which the commercial agent has been appointed by the principal, the "non-genuine agency agreements" (Guidelines on Vertical Restraints (OJ 2000, C291/01)). The Guidelines state that the question of risk must be assessed on a case-by-case basis with regard to the economic reality of the situation rather than the legal form (nos. 12-17). Nevertheless, the Commission considers that Article 81(1) will generally not be applicable to the agent's obligations.

The provisions included in this Chapter apply to commercial agency contracts only to the extent that they are valid in the light of competition law.

Section 2: Obligations of the commercial agent

IV.E.–3:201: Negotiate and conclude contracts

The commercial agent must make reasonable efforts to negotiate contracts on behalf of the principal and to conclude the contracts which the agent was instructed to conclude.

COMMENTS

A. General idea

The commercial agent must actively negotiate contracts for the principal. The agent may be engaged in negotiations either in its own name or in the principal's name. The agent may also be charged with the conclusion of contracts on the principal's behalf. The agent who is authorised to do so must undertake proper efforts in the performance of this obligation.

B. Interests at stake and policy considerations

Where parties have a commercial agency relationship, the agent is under an obligation to act as an intermediary for the principal by negotiating contracts. The commercial agent must only conclude contracts on the principal's behalf if the parties have so agreed. In both situations the agent is obliged to use its best endeavours.

This provision is protective of the principal. It is meant to avoid negative effects on the principal's business because of the agent's non-compliance with its obligations. The agent

should not affect the relationship between the principal and the customers by acting without due care. The principal may lose its good reputation and the customers may refrain from contracting with it and its turnover may decrease. This rule is of special importance where the agent is charged with concluding contracts, because then the transactions entered into by the agent create legal consequences for the principal.

On the other hand, the agent, too, has an important reason to comply with this obligation: its income will be directly or indirectly related to the number and value of contracts concluded between the principal and the customer. Moreover, this obligation is not unreasonably burdensome for the agent: it does not mean that it must always succeed in negotiating and concluding a certain number of contracts. The agent does not fail to perform this obligation merely because a contract is not concluded.

C. Reasonable efforts

The commercial agent must do its best to negotiate and, if the parties so agree, to conclude contracts. Reasonableness in the context of the Article is to be judged by the criteria mentioned in the definition of that term in Annex 1. What is “reasonable” is to be objectively ascertained, having regard to the nature and purpose of what is being done, to the circumstances of the case and to any relevant usages and practices. The agent cannot sit back, wait and incidentally pass on orders to the principal, but must actively search for potential customers and try to convince them to conclude contracts with the principal. The agent cannot guarantee, however, that its negotiations will always be successful. The agent must use its best endeavours.

This objective standard may require adaptations for two reasons. In the first place, a higher or lower standard of activity may be required according to the principal’s expectation of the agent’s reputation or experience, which is justified given the circumstances of the case. In the second place, it is possible that the contract contains specific requirements regarding the level of activity expected of the agent. Whether or not the agent uses its best efforts may affect its right to commission.

D. Negotiate contracts

The task of the commercial agent who negotiates contracts on behalf of the principal is to prepare transactions by searching for customers and convincing them to enter into a contractual relationship with the principal. The fact that the agent negotiates contracts on behalf of the principal neither creates obligations for the agent towards the (potential) customers nor vice versa. The agent may however be liable vis-à-vis the principal if it does not negotiate properly. The agent may, for instance, have neglected the reasonable instructions given by the principal (IV.E.–3:202 (Instructions)). Moreover, mere negotiations are not binding upon the principal and the potential customer. Only if and to the extent that the principal and the customer have actually concluded a contract, will they be bound.

E. Conclude contracts

The principal may charge the commercial agent with the conclusion of contracts on its behalf either on a permanent or incidental basis. The commercial agent is under an obligation to undertake reasonable efforts to do so. This means, for instance, that the agent who has successfully negotiated a contract, should approach the customer within a reasonable time in order to conclude the contract.

Where the agent has the right and the obligation to conclude contracts, the commercial agent must also deal with complaints by customers regarding the products involved. The parties may agree that the agent must also accept payments on the principal's behalf and, if so, under which conditions.

In relation to the conclusion of contracts reference should be made to Part D (Mandate), although in case of conflict the rules in this Chapter prevail (IV.E.–1:201 (Priority rules)).

IV.E.–3:202: Instructions

The commercial agent must follow the principal's reasonable instructions, provided they do not substantially affect the agent's independence.

A. General idea

The agent must comply with the instructions given by the principal. The agent has to follow only instructions which are reasonable in view of the content and the nature of the agreement. In order to be reasonable, instructions must be given in a timely fashion.

However, the principal may never substantially affect the agent's independence. The agent may arrange its activities and use its time as it thinks fit.

B. Interests at stake and policy considerations

The commercial agent may, as an intermediary, bind the principal if it concludes contracts in the principal's name. Therefore, it is important for the principal that the commercial agent closely follows the principal's instructions. Without this obligation, the agent could negotiate (and conclude) contracts on the principal's behalf without following instructions. This would be contrary to the principal's purpose of appointing an intermediary to represent its interests.

While this Article protects the interests of the principal, it also takes into account the fact that the agent has an interest in remaining autonomous. Moreover, the agent does not have to follow any instructions by the principal, only those instructions which are reasonable.

C. Reasonable instructions

The commercial agent is only required to follow those instructions which are reasonable. Reasonableness in the context of this Article is to be judged by the criteria mentioned in the definition in Annex 1. The circumstances of the case and the applicable usages must be taken into account as well as what persons acting as a commercial agent and principal in the same situation would consider reasonable.

The principal usually has its own business policies relating to the conditions of sale such as the prices of the products, the production and delivery terms, the terms of payment and the procedure for dealing with customers' claims. Generally, instructions relating to these policies will be considered reasonable.

Illustration 1

A principal instructs its commercial agent to see its customers once every week. Such an instruction is unreasonable, since it substantially affects the commercial agent's independence.

IV.E.–3:203: Information by agent during the performance

The obligation to inform requires the commercial agent in particular to provide the principal with information concerning:

- (a) contracts negotiated or concluded;*
- (b) market conditions;*
- (c) the solvency of and other characteristics relating to clients.*

COMMENTS

A. General idea

The obligation to inform is imposed by IV.E.–2:202 (Information during the performance): the agent must disclose all the information in its possession which the principal needs for the proper performance of its part of the contractual obligations. The agent must inform the principal of its specific individual situation, concerning issues such as the transactions which were prepared or concluded and with whom. In addition, the agent also must inform the principal concerning more general issues, such as the market in which the agent operates. The list of required information in this Article is not exhaustive.

B. Interests at stake and policy considerations

While the principal is the party who will be bound by a sales or service contract negotiated by the agent, the principal is not in a position to verify, for instance, the customer's solvency or reputation. It is thus important for the good functioning of the principal's business that the principal is provided with such information. The principal needs to know how many and which contracts have been negotiated regarding its products in order to decide whether it will conclude a certain contract. Information about the market in which the agent operates enables the principal to judge whether the agency will remain worthwhile.

This obligation is not unreasonably burdensome for the agent: the agent only has to communicate the information which is available to it, in so far as this is needed by the principal for the performance of its obligations in relation to the agent and the customers.

C. Information to be provided

The agent must inform the principal of its past, present and future activities, the customers found and the market situation in which it operates. This information is relevant to the need for the principal to perform the obligations under the contracts with the agent and the customer or customers.

Under this obligation the agent must make reasonable efforts to ensure that the information is correct. In this respect information concerning the market must be distinguished from information concerning the agent's own activities. With respect to the former it will be more difficult for the agent to obtain accurate information, since it concerns more variable

(unforeseeable) factors. However, concerning the latter, the standard of care may be a higher one in the case of information concerning its own activities.

Contracts negotiated or concluded. Apart from informing the principal of the contracts concluded or negotiated, this obligation includes, amongst other things, the obligation to transmit third parties' complaints or claims which the agent has received or has become aware of and special demands by customers concerning the products involved.

Market Conditions. These conditions include, among other things, modifications in demands by customers, price developments and the state of competition. The obligation is limited to information relating to the agent's territory.

The solvency of and other characteristics relating to customers. This obligation is limited to the customers' relevant characteristics, the main one being solvency. However, the principal does not need to know all the characteristics relating to customers if the agent may conclude the contract on the principal's behalf. In that case the characteristics of the customers represent a value for the agent, which it is not obliged to share with the principal.

D. No formalities

There is no general form requirement as to the way in which this information is to be provided. The aim of the Article is merely to oblige parties to communicate.

IV.E.–3:204: Accounting

(1) The commercial agent must maintain proper accounts relating to the contracts negotiated or concluded on behalf of the principal.

(2) If the agent represents more than one principal, the agent must maintain independent accounts for each principal.

(3) If the principal has important reasons to doubt that the agent maintains proper accounts, the agent must allow an independent accountant to have reasonable access to the agent's books upon the principal's request. The principal must pay for the services of the independent accountant.

COMMENTS

A. General idea

The commercial agent has to keep proper accounts, in particular relating to the contracts it has negotiated or concluded (paragraph (1)). The agent has to keep documentation concerning the customers involved in the contracts. Where appropriate, the agent must maintain accounts of payments receivable on the principal's behalf and of the products of the principal. Where the agent represents more than one principal, this obligation to keep accounts also obliges the agent to keep separate accounts for each principal it represents (paragraph (2)). This provision entitles the principal to verify whether the agent actually complies with the obligation to keep proper accounts in paragraph (1), when the principal has reasons to doubt that the commercial agent keeps proper accounts. This may be the case, for instance, when the information provided by the agent is not correct, or the information is not provided in due time or in the case of a sudden decrease in the number of contracts negotiated (paragraph (3)).

B. Interests at stake and policy considerations

For the performance of its obligations under the contract, the principal needs specific information from the agent. Accordingly, it is reasonable to expect the agent to keep proper accounts. Proper accounts also include keeping separate accounts for different principals.

This provision entitles the principal to verify whether the agent actually keeps proper accounts. However, the principal may inspect the agent's books only if the principal has important reasons to believe that the agent does not keep proper accounts. The agent is not obliged to disclose information in the books which it keeps in its relationship with other principals, if the agent complies with its obligation to keep separate accounts (paragraph (2)).

Although this provision seems to favour mainly the principal, it is not unreasonably burdensome for the agent, who as a professional will usually keep proper accounts. Where the agent complies with this obligation to keep accounts, it will be easier for it to comply with the obligation to inform. The agent also needs proper accounts for its own purposes, for instance because it has to know which commission it is entitled to in relation to which contracts and from which principal. After the contract, the commercial agent may require proper accounts in order to prove that the principal cannot terminate the contract for non-performance.

C. Proper accounts

The agent is always obliged to keep books relating to the contracts it successfully negotiates or concludes with customers on the principal's behalf. If the agent has the principal's products at its disposal, the accounts will include an overview of how the agent disposes of them. If the parties have agreed that the agent must accept customers' payments in the principal's name, an overview of all sums received and to be received are also to be included in the agent's books. If the commercial agent represents more than one principal, it must maintain independent accounts for each principal represented.

Section 3: Obligations of the principal

IV.E.–3:301: Commission during the agency

(1) The commercial agent is entitled to commission on any contract concluded with a client during the period covered by the agency, if:

(a) the contract has been concluded

(i) as a result of the commercial agent's efforts;

(ii) with a third party whom the commercial agent has previously acquired as a client for contracts of the same kind; or

(iii) with a client belonging to a certain geographical area or group of clients with which the commercial agent was entrusted; and

(b) either

(i) the principal has or should have performed the principal's obligations under the contract; or

(ii) the client has performed the client's obligations under the contract or justifiably withholds performance.

(2) The parties may not, to the detriment of the commercial agent, exclude the application of paragraph (1)(b)(ii) or derogate from or vary its effects.

COMMENTS

A. General idea

One of the characteristics of a commercial agency is that the main part of the agent's remuneration typically consists of commission. During the contract period the commercial agent is entitled to commission on contracts concluded during this period if these contracts were entered into as a result of the agent's activity or if these contracts were concluded with customers which the agent has previously acquired for contracts of the same kind (paragraph (1)(a)(i) and (ii)).

However, the agent can also be entitled to commission on contracts which have not been negotiated or concluded by the agent: when the customer belongs to the agent's area or group of customers (paragraph (1)(a)(iii)).

The agent is entitled to commission as soon as the obligations under the contract have or should have been performed (paragraph (1)(b)). The parties may agree that the entitlement to commission arises before performance by either the principal or the customer, for instance when the contract is concluded. However, they may not agree that the entitlement to commission arises at a moment which is later than the customer's performance (paragraph (2)).

B. Interests at stake and policy considerations

In the case of commission-based remuneration the interests of the agent and those of the principal run parallel: both parties aim at a maximum number of successful contracts. If the agent does not find many customers willing to conclude contracts, not only are the gains of the principal directly affected, but also the agent's income is reduced. It is no different when the agent has made important investments. Thus, commission-based remuneration gives the agent an incentive to use its best efforts to negotiate or conclude as many contracts as possible.

This Article gives the agent, in principle, a right to commission on contracts which are the result of its activities. The agent's interest in earning commission is well protected in case the agent is entrusted with a specific area or group of customers. Then it is, in principle, entitled to commission whether or not its activities have contributed to the contract and whether or not it has an exclusive right to such an area or group of customers: the mere fact that the customer belongs to that area or group is sufficient for its entitlement.

Paragraph (1)(b) provides incentives for the agent to negotiate contacts with reliable customers, since the mere conclusion of the contract does not entitle the agent to commission. Only when the contractual obligations are performed by one of the parties is the agent entitled to commission. However, this does not burden the agent unreasonably. Paragraph (1)(b) also provides that commission is earned in certain specific situations, even though the contractual obligations have not yet been performed. This is the case when the principal should have performed or the customer justifiably withholds its performance. Paragraph (2) determines that, whatever the parties have agreed upon in their contract, the agent's entitlement to commission arises with the customer's performance or the customer's justified exercise of its right to withhold its performance.

C. Result of the agent's efforts

In order to be entitled to commission, the agent must actively negotiate with customers on the principal's behalf, by locating potential customers or groups of customers and trying to persuade them to conclude a contract with the agent or the principal. The negotiating agent must communicate offers to the principal. The mere fact that the agent has mentioned a customer is insufficient to give a right to commission. The agent must have contributed to the conclusion of the contract between the customer and the principal in an identifiable, considerable and useful manner. However, it is not required that the agent has made efforts to acquire the customer with the purpose of concluding a particular contract; the agent is also entitled to commission when it has acquired the customer at an earlier stage for contracts of the same type.

Illustration 1

A has a mobile telephone network. B, as a commercial agent for A, procures customers who will obtain a mobile telephone subscription to that network. During the period of the agency between A and B, A directly approaches the customers procured by B to subscribe to that mobile phone network. B is also entitled to commission on the contracts with those customers.

D. Customers from a specific geographical area or group

This Article entitles the agent to commission regardless of whether its efforts have led to the conclusion of a contract between the principal and the customer. The fact that the agent is working in a certain territory or with a certain group of customers and that the principal concludes a contract with a customer belonging to this territory or group during the period of the agency, creates for the agent a direct entitlement to commission. In this case the agent does not have to prove that the conclusion of the contract was the result of its actions.

E. Performance of the contract with the customer

The agent's entitlement to commission exists only when its activities have proved to be effective, i. e. when the obligations under the contract have or should have been properly performed. The principal then owes the agent the commission on that particular transaction. This obligation to pay commission does not mean that the agent may immediately claim the agent's commission as the commission is to be paid periodically (see IV.E.-3:304). The agent may demand payment only from the expiry of the agreed period (at the latest three months). If the agent claims payment before that period, the principal may justifiably withhold performance until that moment.

F. Amount of commission

This Article leaves it to the parties to agree upon the rate of the commission and the method of calculating it. The parties usually explicitly stipulate in a detailed manner the rate of the agent's remuneration. The parties may agree that the rate of commission will be higher for contracts concluded as a result of the agent's efforts than for contracts concluded with customers belonging to the agent's area or group of customers.

In the absence of any agreement on this matter between the parties the contract is not invalid; a normal or reasonable commission is substituted in accordance with II.-9:104 (Determination of price). Factors which play a role in determining whether the amount of commission is reasonable include: the type and place of transactions, the type of goods or services, their price, the efforts made by the agent et cetera. Also, for instance, the length of

the period during which the agent has to wait until it may claim the payment of the commission which it has earned can be taken into account.

G. Character of the rule

The parties may not derogate from paragraph (1)(b)(ii) to the detriment of the commercial agent.

IV.E.–3:302: Commission after the agency has ended

(1) The commercial agent is entitled to commission on any contract concluded with a client after the agency has ended, if:

(a) either

(i) the contract with the client is mainly the result of the commercial agent's efforts during the period covered by the agency contract, and the contract with the client was concluded within a reasonable period after the agency ended; or

(ii) the requirements of paragraph (1) of IV.E.–3:301 (Commission during the agency) would have been satisfied except that the contract with the client was not concluded during the period of the agency, and the client's offer reached the principal or the commercial agent before the agency ended; and

(b) either

(i) the principal has or should have performed the principal's obligations under the contract; or

(ii) the client has performed the client's obligations under the contract or justifiably withholds the client's performance.

(2) The parties may not, to the detriment of the commercial agent, exclude the application of paragraph (1)(b)(ii) or derogate from or vary its effects.

COMMENTS

A. General idea

Even if the agency has ended, the agent is still entitled to commission in two situations. First, when the contract is concluded within a reasonable time after the agency ended (paragraph (1)(a)(i)). Secondly, when the offer from the customer has reached either the principal or the agent before the end of the agency (paragraph (1)(a)(ii)). This rule merely deals with a transition period: although the parties will not continue the contractual relationship in the future, they still have a relationship in the sense that one party has undertaken activities during the period of the agency for which it would have been remunerated had the relationship not ended.

This Article applies for instance in the case where the agent has negotiated sales contracts for the supply of goods to be ordered and delivered periodically after the termination of the agency or where the principal has concluded contracts the obligations under which will be performed only after the termination of the agency.

B. Interests at stake and policy considerations

In the two situations mentioned above, it is considered reasonable to entitle the agent to commission on the contracts in question. It is assumed that the principal will benefit from the transaction which will be concluded shortly after the ending of the agency relationship. The

rule protects the commercial agent's interest in receiving payment for its efforts made before the ending of the relationship.

However, the agent cannot expect to receive commission on transactions concluded a long time after the ending of the agency. This right to commission is limited to a limited number of specific situations. This rule therefore also takes into account the principal's interests.

C. Reasonable period

The parties are free to agree upon a period rather than leave it to the reasonableness test in paragraph (1)(a)(i). Reasonableness in the context of this Article is to be judged by the criteria mentioned in the definition of that term in Annex 1. For instance, the nature and purpose of the contract, the circumstances of the case, and the usages and practices of the trade or profession involved must be taken into account. Factors which play a role in order to determine a reasonable period include, for instance, the volume of the transactions and the time it normally takes the principal to conclude a contract negotiated by the agent. A reasonable term is normally no longer than 6 months.

D. Mainly the result of the agent's efforts

The requirements relating to the agent's entitlement after the agency has ended are stricter than those in IV.E.-3:301 (Commission during the agency). The agent has to prove not only that it played an active role in locating customers, negotiating with them and concluding the contract, but also that the conclusion was mainly due to its efforts. However, if the agent proves that the conclusion is primarily due to its actions, the agent may be entitled to commission in two situations – first, when the contract is concluded within a reasonable period after the ending of the agency; secondly, when the customer's offer reached the agent or the principal before the ending of the agency.

E. Performance of the contract with the customer

Another requirement for the existence of the agent's entitlement to commission is that the agent's activities have proved to be effective, i. e. when the obligations under the contract have, or should have been, properly performed. The principal then owes the agent the commission on that particular transaction. This obligation to pay commission does not mean that the agent may immediately claim commission; the commission is to be paid periodically (see IV.E.-3:304). The agent may only demand payment from the expiry of the agreed period (at the latest three months). If the agent claims payment before that period, the principal may justifiably withhold performance until that moment.

F. After the agency has ended

This Article applies to situations where the contractual relationship has come to an end for whatever reason. It applies for example where a relationship entered into for a definite period has expired and where a contractual relationship has been terminated unilaterally, whether or not for non-performance.

G. Relation to an indemnity for goodwill and to damages for non-observance of the period of notice

The entitlement to commission after the end of the agency may not cumulate with an Entitlement to an indemnity for goodwill (IV.E.-2:305) when the agency is terminated. Both rules are based on the same idea of restitution.

However, the entitlement to commission may cumulate with an entitlement to damages under IV.E.–2:303 (Damages for termination with inadequate notice).

Illustration 1

After 15 years, A, the principal, ends the agency of B, the commercial agent, by giving two months' notice. B claims the payment of commission according to the present Article, indemnity for goodwill }and damages for termination with inadequate notice. A court will grant either (i) the payment of commission according to the present Article and damages for termination with inadequate notice or (ii) indemnity for goodwill and damages for termination with inadequate notice.

H. Character of the rule

The parties may not derogate from paragraph (1)(b)(ii) to the detriment of the commercial agent.

IV.E.–3:303: Conflicting entitlements of successive agents

The commercial agent is not entitled to the commission referred to in IV.E.–3:301 (Commission during the agency) if a previous commercial agent is entitled to that commission under IV.E.–3:302 (Commission after the agency has ended), unless it is reasonable that the commission is shared between the two commercial agents.

COMMENTS

A. General idea

This provision concerns cases in which the two preceding Articles may conflict, i. e. where an agent has been replaced by another agent and both claim their commission on transactions which have been concluded. According to the present rule, usually the first agent is entitled to the commission. However, certain circumstances may lead to the conclusion that the two agents must share the commission on a transaction, in particular when both of them have contributed to it.

B. Interests at stake and policy considerations

Conflicts may arise between the first and the second agent relating to the question of who should receive the commission on a particular transaction. This rule protects the first agent's interest. If the first agent shows that the transaction was mainly due to its efforts and either the contract was concluded shortly after the ending of the agency or the customer's offer reached the first agent or the principal before the ending of the agency, then it is assumed that the transaction is due to the first agent's efforts more than to those of its successor.

However, the entitlements of the first agent can arise only during a short period after the ending of the agency and if all the requirements of IV.E.–3:302 have been met. This rule is therefore not unreasonably burdensome for the second agent. Moreover, it leaves open the possibility that both agents should share the commission.

Finally, this rule takes care of the principal's interest in the sense that the principal will never have to pay commission twice on a certain transaction.

C. Reasonableness of shared entitlement

Whether it is reasonable that the two agents share their entitlement to commission on a particular transaction depends to a large extent upon their respective contributions to the conclusion of the contract. In particular if the second agent's contribution to the conclusion of the contract was substantial, then the first agent's right will not necessarily prevail. If both agents are entitled to commission on the same transaction, each party's share must be reasonable.

IV.E.-3:304: When commission is to be paid

(1) The principal must pay the commercial agent's commission not later than the last day of the month following the quarter in which the agent became entitled to it.

(2) The parties may not, to the detriment of the commercial agent, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The parties may agree upon periodical payments of commission by the principal. The present rule provides a minimum standard: while the parties may agree that the principal must pay at an earlier date, they may not agree that the principal must pay at a later date. If the parties have not agreed on a period for payment, the commission is to be paid every three months. The moment of payment is usually also the moment when the statement of the commission to which the agent is entitled has to be supplied (see IV.E.-3:310 (Information on commission)).

According to this rule, the agent may have to wait in claiming commission for up to three months after it has earned it. The fact that the principal has free use of the money for an extra period can be taken into account when the rate of commission is fixed.

B. Interests at stake and policy considerations

This Article, on the one hand, protects the agent in the sense that the parties may not agree that the principal can pay at a later moment than once every three months, while they remain free to agree on, for instance, monthly payments.

On the other hand, it allows the commission to be paid periodically which is mainly in the interest of the principal. It means that the commission earned on separate contracts is calculated over a certain period (three months) and paid at the end of that period.

C. Relation to other provisions

The general rule is that the time at which an obligation is to be performed depends on the terms regulating the obligation, which failing the obligation must be performed within a reasonable time after it arises (III.-2:102 (Time of performance)). The terms regulating the obligation may be derived from the law (III.-1:101 (Definitions) paragraph (5)). The present Article is an example of specific legal regulation of the time of performance.

However, the present rule deviates from III.–2:102 (Time of performance) in the sense that it limits the parties' freedom to determine the time of performance in their contract: the parties may not agree that the principal must pay on a later moment than provided for in this Article.

D. Character of the rule

This rule is mandatory: the parties may not agree that the principal must pay later than once every three months.

E. Remedies

The normal remedies for non-performance of a monetary obligation are available. The agent is in particular entitled to claim interest from the moment when the principal has failed to pay the commission which became due, *i. e.* at the end of the period fixed for payment (at the latest three months).

IV.E.–3:305: Entitlement to commission extinguished

(1) The commercial agent's entitlement to commission under IV.E.–3:301 (Commission during the agency) and IV.E.–3:302 (Commission after the agency has ended) can be extinguished only if and to the extent that it is established that the client's contractual obligations will not be performed for a reason for which the principal is not accountable.

(2) Upon the extinguishing of the commercial agent's entitlement to commission, the commercial agent must refund any commission already received.

(3) The parties may not, to the detriment of the commercial agent, exclude the application of paragraph (1) or derogate from or vary its effects.

COMMENTS

A. General idea

In principle, each contract concluded by the principal as a result of either the agent's efforts or with a customer from the agent's area entitles the agent to commission once either the principal or the customer has performed the obligations under the contract (see IV.E.–3:301 (Commission during the agency) and IV.E.–3:302 (Commission after the agency has ended)). The parties may agree that such an entitlement is extinguished, if the obligations under the contract with the customer are not performed. They may agree that the agent is to repay commission already paid but even if they do not expressly agree this the principal may recover any commission previously paid to the agent (paragraph (2)).

However, the agent cannot lose its right to commission when the principal is accountable for the non-performance (paragraphs (1) and (3)).

B. Interests at stake and policy considerations

The principal has an interest in not paying commission on transactions which have not been successfully brought to a successful end. Moreover, the present provision is advantageous to the principal because it entitles the principal to recover the commission which it has already paid for such transactions.

The commercial agent is also protected in the sense that it cannot lose its right to commission where the principal is itself responsible for the non-performance.

C. Non-performance of the obligations under the contract with the customer

Extinguishing the agent's right to commission can only occur if it is established that the obligations under the contract with the customer will not be performed and that the non-performance is not due to the principal. This rule may therefore be applicable when it is clear that the customer can or will not perform the customer's obligations under the contract or when the principal can be excused non-performance under III.-3:104 (Excuse due to an impediment). If the principal is however accountable for the non-performance, the agent is entitled to commission.

D. Character of the rule

Paragraph (1) of this rule is mandatory in the sense that the parties may not deviate therefrom to the detriment of the commercial agent. The second paragraph is a default rule: parties are free to agree otherwise.

IV.E.-3:306: Remuneration

Any remuneration which wholly or partially depends upon the number or value of contracts is presumed to be commission within the meaning of this Chapter.

COMMENTS

A. General idea

If the parties have agreed that the agent is entitled to a remuneration which is completely or partially dependent upon the amount or value of the resulting transactions without explicitly referring to it as commission, then the rules on commission will nevertheless apply.

B. Interests at stake and policy considerations

The presumption that any remuneration which depends upon the number or value of contracts amounts to commission is in the commercial agent's interest, because in such cases the protective rules in this Chapter will apply.

C. Basis of remuneration

Although the remuneration is normally calculated on the basis of contracts with customers which have been concluded and the obligations under which have been performed (IV.E.-3:301 (Commission during the agency) and IV.E.-3:302 (Commission after the agency has ended) the parties may agree upon a remuneration which does not depend on the amount or value of the contracts. Moreover, even though the agent will normally mainly or solely be paid by commission, the parties may agree that it will in addition be entitled to a fixed amount of money over a certain period or under certain conditions. Such remuneration may give the commercial agent the security of some income at the beginning of the relationship. At a later stage, the parties may agree on a fixed minimum sum in case the principal does not have any work for the agent, or not as much as usual, as a result of the principal's production capacity or company policies. Such a fixed amount then entitles the agent to a minimum income. It

follows from the present Article that the rules on commission in this Chapter do not apply to such a fixed income.

IV.E.–3:307: Information by principal during the performance

The obligation to inform requires the principal in particular to provide the commercial agent with information concerning:

- (a) characteristics of the goods or services; and*
- (b) prices and conditions of sale or purchase.*

COMMENTS

A. General idea

During the agency contract, the principal must disclose all the information in its possession which the agent needs for the proper performance of its obligations under the contract (IV.E.–2:103 (Information during the performance)). The principal must inform the agent, in particular, concerning the products to be sold or purchased and the conditions under which the principal will conclude contracts with customers. This implies that the principal must also provide the agent with all relevant documentation where this is appropriate. The list of required information is not exhaustive.

B. Interests at stake and policy considerations

If the agent does not know which products the principal wants to sell or purchase and for which price, it will not find many customers willing to conclude a contract. Therefore, the principal must disclose information relating to the products involved and the conditions under which the principal wants to contract. This duty to provide information is not unreasonably burdensome for the principal: it only has to provide the agent with the information and documentation available to it, in so far as this is required by the agent for the performance of its obligations under the agency contract.

C. Relation to other provisions

This Article may be regarded as a further specification of the obligation to inform under IV.E.–2:103 (Information during the performance) and more generally of the obligation to cooperate under III.–1:104 (Co-operation).

D. Information to be provided

There is no general form requirement as to the way in which this information is to be provided. Depending on the circumstances the principal may, for instance, communicate the information to the agent by means of documents relating to the products, such as leaflets and standard contract forms. Unless otherwise agreed, this documentation must be provided free of charge.

The obligation is not an obligation of result as to the quality of the information: the principal must make reasonable efforts to ensure that the information is correct.

Characteristics of the products. The principal must provide the agent with information concerning all the relevant characteristics of the products involved. If the principal decides that it will purchase or sell other products, it must inform the agent and provide it with all the

relevant information regarding the new products. The principal may be obliged to provide relevant documentation, for instance samples and designs.

Prices and sales conditions. Such information may include, for instance, information concerning prices, the terms of payment, the terms of delivery, the principal's commercial policy (for what type of customers the goods are meant) and any modifications to these. This obligation to inform may include the obligation on the part of the principal to provide documentation, such as price lists and printed advertising material.

IV.E.–3:308: Information on acceptance, rejection and non-performance

(1) The principal must inform the commercial agent, within a reasonable period, of:

(a) the principal's acceptance or rejection of a contract which the commercial agent has negotiated on the principal's behalf; and

(b) any non-performance of obligations under a contract which the commercial agent has negotiated or concluded on the principal's behalf.

(2) The parties may not, to the detriment of the commercial agent, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The principal has to inform the agent, who negotiates contracts on its behalf, concerning any follow-up action relating to offers or orders procured by it. The agent is entitled to know whether a transaction has been accepted, accepted subject to conditions or rejected. This provision does not mean that the principal has to provide reasons for refusing a transaction: the mere statement that a particular transaction has been refused without specifying any detail will be sufficient. It does, however, include an obligation for the principal to inform the agent on a more general level whether, as a rule, the principal will refuse a certain type of customer or contract. Where the contract with the customer has been concluded, the agent must be informed regarding any non-performance of the obligations under the contract. The agent is entitled to this information within a reasonable period.

B. Interests at stake and policy considerations

This obligation is important for the negotiating agent because it enables the agent (i) to calculate its commission, (ii) to verify whether refusals have been given systematically, arbitrarily or in bad faith, and (iii) to inform the customers regarding the principal's reaction. It is also relevant for the agent who actually concludes contracts, because the fact that obligations under a contract have not been performed, may either completely remove the agent's right to commission or temporarily prevent the agent from demanding commission (IV.E.–3:301 (Commission during the agency) and IV.E.–3:302 (Commission after the agency has ended)). Where appropriate, the performance also determines the agent's *del credere* liability (IV.E.–3:313 (Del credere clause)). The agent itself cannot easily obtain information concerning the performance of the obligations under the contract with the customer, because after the negotiations (and the conclusion) the agent is no longer involved in the transaction between the principal and the customer.

This rule also takes the interest of the principal into account. The principal serves its own reputation if the agent can speedily answer a potential customer. Moreover, if the principal informs the agent in due time that it does not want to conclude a certain contract, no right to commission comes into existence. The present rule is not unreasonably burdensome for the principal, who has this information available. The principal knows whether it will accept or reject an order. The rule leaves the principal with reasonable time to decide whether it wants to conclude the contract. The principal will know more about the performance of the contractual obligations than the agent, because after the negotiations on (and the conclusion of) the contract by the agent, it will directly contact the customer and vice versa.

C. Character of the rule

This rule is mandatory; the parties may not deviate from it to the detriment of the commercial agent (paragraph 2).

IV.E.–3:309: Warning of decreased volume of contracts

(1) The principal must warn the commercial agent within a reasonable time when the principal foresees that the volume of contracts that the principal will be able to conclude will be significantly lower than the commercial agent could reasonably have expected.

(2) For the purpose of paragraph (1) the principal is presumed to foresee what the principal could reasonably be expected to foresee.

(3) The parties may not, to the detriment of the commercial agent, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

This mandatory rule imposes an obligation on the principal to warn the agent regarding changes in its business which are likely to affect the agent's entitlement to commission. This rule takes into account the fact that, within a commercial agency, circumstances may change. If the principal foresees that its business capacity will diminish to a greater extent than the agent could reasonably expect, this rule obliges it to warn the agent. Because of the difficulty of proving what the principal actually foresaw, paragraph (2) introduces a presumption that the principal foresaw what it could reasonably be expected to have foreseen.

B. Interests at stake and policy considerations

If the principal does not inform the agent regarding, for instance, a decrease in the principal's production, the principal may refuse more orders than the agent would reasonably expect. This warning may be essential for the agent, because the agent's income depends solely, or to a large extent, on the amount of contracts concluded. The warning enables the agent to search for other means of income in time. This provision also avoids the situation where the agent incurs expenses in locating customers and negotiating contracts which the principal will eventually not conclude.

This obligation to warn is also in the principal's own interests. If the agent is warned a sufficient time in advance, it will not negotiate with customers in vain; the customers will not be disappointed and the principal's reputation will not be affected. This obligation is not

unreasonably burdensome for the principal, because the principal does not have to provide the agent with the reasons why the volume of transactions will change, nor does the principal have to warn that this may lead to the ending of the agency. The principal must only warn the agent if it foresees a considerable change in volume.

C. Volume of contracts

The volume of contracts is the total amount of contracts during a certain period of time. The principal has to inform the agent both in situations where a decrease in volume is due to factors within the principal's control and where the decrease is due to a change in the market.

D. Reasonableness

The reasonableness of the time within which the warning is given must be assessed in accordance with the criteria mentioned in the definition of "reasonable" in Annex 1. Factors to be taken into account include the nature and purposes of the contract, the circumstances of the case, and the usages and practices of the trade or profession involved. The same goes for the reasonableness of the agent's expectations. A good test to determine the agent's reasonable expectation will in most cases be the average volume of contracts with customers over the previous 5 years, or if the contract has been in existence for less than 5 years, over the whole period.

E. Character of the rule

This rule is mandatory; the parties may not deviate therefrom to the detriment of the commercial agent (paragraph. (3)).

IV.E.–3:310: Information on commission

(1) The principal must supply the commercial agent in reasonable time with a statement of the commission to which the commercial agent is entitled. This statement must set out how the amount of the commission has been calculated.

(2) For the purpose of calculating commission, the principal must provide the commercial agent upon request with an extract from the principal's books.

(3) The parties may not, to the detriment of the commercial agent, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The agent has a right to obtain, within a reasonable period, a statement of the commission that the agent has earned. The agent may furthermore request the principal for an extract from the principal's books, in so far as the information which the agent requests concerns the agent's entitlement to commission.

B. Interests at stake and policy considerations

The commercial agent has a right to know the amount of the commission which it has earned. However, the agent is not necessarily aware that a contract which it has negotiated, and possibly concluded in the name of the principal, has actually led to performance of the obligations under it. This information is typically information which the principal has in its

books. The principal must therefore provide the agent with regular overviews of the commission which has become due and, in addition, enable the agent to verify this statement by providing the agent with an explanation of the calculation used. The statement, including the calculation method, should place the agent in a position to make its own calculation.

This obligation is not unreasonably burdensome for the principal. The principal has reasonable time to make and to provide the statement of the commission to which the agent became entitled. This obligation does not require much extra effort, because the principal has to make this calculation anyway in order to be able to comply with its own obligation under the agency contract, i. e. to pay commission to the agent.

C. Relation to other provisions

“Reasonableness” is defined in general terms in Annex 1. The statement is a notice in the sense of II.–1:106 (Notice). Therefore, the statement may be given by any means appropriate to the circumstances and becomes effective when it reaches the commercial agent.

D. Reasonable period

The parties may agree upon the moment when the principal has to provide the statement of commission. However, the term must be reasonable. To assess what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved must be taken into account. However, normally it will be reasonable for the principal to provide the agent with the commission statement at or before the moment when the commission has to be paid.

E. Character of the rule

This rule is mandatory; the parties may not deviate therefrom to the detriment of the commercial agent.

IV.E.–3:311: Accounting

(1) The principal must maintain proper accounts relating to the contracts negotiated or concluded by the commercial agent.

(2) If the principal has more than one commercial agent, the principal must maintain independent accounts for each commercial agent.

(3) The principal must allow an independent accountant to have reasonable access to the principal’s books upon the commercial agent’s request, if:

(a) the principal does not comply with the principal’s obligations under paragraphs (1) or (2) of IV.E.–3:310 (Information on commission); or

(b) the commercial agent has important reasons to doubt that the principal maintains proper accounts.

COMMENTS

A. General idea

The principal has obligations under IV.E.–2:202 (Information during the performance) and IV.E.–3:307 (Information by principal during the performance) to provide the agent with all the information the agent needs for the proper performance of the obligations under the

contract. In order to properly fulfil these and other obligations the principal has to keep proper accounts, in particular relating to any follow-up action with regard to contracts negotiated by the agent on the principal's behalf, the agent's right to commission and the principal's volume of business. The principal must also keep documentation concerning the products involved in the contracts.

If the statement or the extract supplied by the principal in accordance with the preceding Article is incorrect, the commercial agent may have an important reason to doubt that the principal keeps proper accounts. The agent may then request an inspection of the principal's books by an independent accountant.

B. Interests at stake and policy considerations

For the performance of the commercial agent's obligations under the contract, the agent needs specific information from the principal. Accordingly, the principal may reasonably be expected to keep proper accounts. As a professional the principal will usually do so. Where the principal complies with this obligation to keep proper and separate accounts, it will be easier for the principal to comply with its other obligations under this Section. The principal thus also needs proper accounts for its own purposes.

This provision entitles the agent to verify, by means of an independent third party, whether the principal actually keeps proper accounts. The agent is also allowed to have such an inspection carried out, in the case where the principal does not comply with its obligation to provide a commission statement or an extract from the books under IV.E.-3:310 (Information on commission).

This provision takes into account the principal's interests in keeping its administration secret, because the agent is not granted direct access to the principal's books. Moreover, the agent has no general right to inspect the principal's administration. The agent can only do so in a limited number of situations, i. e. where the agent has important reasons to suspect that the principal has failed to perform its obligations properly. Finally, the inspection of the books by the accountant takes place at the agent's expense.

C. Proper accounts

The principal is always obliged to keep accounts relating to the products involved, the commission due and the follow-up action relating to those contracts which are the result of the agent's activities.

IV.E.-3:312: Amount of indemnity

(1) The commercial agent is entitled to an indemnity for goodwill on the basis of IV.E.-2:305 (Indemnity for goodwill) amounting to the average commission on contracts with new clients and on the increased volume of business with existing clients calculated for the last 12 months, multiplied by the number of years the principal is likely to continue to derive benefits from these contracts in the future.

(2) The resulting indemnity must be amended to take account of:

- (a) the probable attrition of clients, based on the average rate of migration in the commercial agent's territory; and*
- (b) the discount required for early payment, based on average interest rates.*

(3) In any case, the indemnity must not exceed one year's remuneration, calculated from the commercial agent's average annual remuneration over the preceding five years or, if the contractual relationship has been in existence for less than five years, from the average during the period in question.

(4) The parties may not, to the detriment of the commercial agent, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

This rule aims to provide a method for calculating the amount of indemnity to which the agent may be entitled according to IV.E.-2:205 (Indemnity for Goodwill). In order to do so, two steps must be taken. The first step concerns the identification of the new customers and the existing customers whose volume in the principal's business increased considerably.

Then, the agent's average commission that was paid on these customers is calculated for the last twelve months prior to the termination of the agency. Subsequently, the duration of these benefits for the principal must be estimated. Next, the rate of migration must be considered. The rate of migration is calculated on a yearly basis and is reduced for each year with a certain percentage of the commission for the migration rate, and the average interest rate must be taken into account as well (paragraph (2)). The second step concerns the comparison between the amount of indemnity calculated on the basis of paragraphs (1) and (2) and the annual average remuneration over the preceding five years. If the amount of indemnity exceeds the annual remuneration, the latter will be awarded. In other words, Paragraph (3) provides for a maximum amount of indemnity.

B. Interests at stake and policy considerations

The policy consideration underlying this rule is that the increased volume of business for the principal represents a benefit for the principal if the agency is terminated for which the agent should be indemnified. The present rule is in the interest of both parties, because it provides legal certainty and avoids extensive transaction and litigation costs for establishing the exact value of the goodwill which has passed between the parties.

In the interest of the commercial agents the calculation method tries to ensure that the agent is indemnified, as much as possible, for the loss of goodwill. On the other hand, the interests of the principal are taken into account by the fact that the principal's benefits usually decrease over time. Moreover, the provision also contains a maximum for the indemnity, which is also in the interest of the principal.

C. New or old customers

Each new customer acquired would usually entitle the agent to commission and must therefore be taken into account when calculating the amount of indemnity. The income which the agent would have earned from services (and other activities) provided to the customers should not be taken into account when calculating the indemnity.

Whether the agent is entitled to an indemnity for goodwill with regard to contracts concluded with previously acquired customers, depends on whether the commercial agent has

substantially increased the volume of business with them. The increase in volume must be such that it equals the acquisition of a new customer in economic terms.

D. Likely future duration of benefits

The principal will not eternally benefit from the agent's activities. In order to determine how long the principal will profit from the continuous advantages which were generated by the agent, an estimation must be made. This estimation depends to a large extent on the market situation and the sector concerned. Usually these benefits last for 2 or 3 years, but they may last for as long as 5 years.

E. Attrition and migration rate

Over time, the principal always loses customers. A customer may conclude just one transaction with a principal without the intention to continue doing so on a regular basis. Also, customers switch to another principal, for instance because the other principal deals in another brand or different products, or they move to another area. The rate of migration is variable and must be evaluated from the particular experience of the agent in question. The rate of migration must be calculated as a percentage of the commission on an annual basis.

F. Discount for early payment by reference to average interest rate

This factor is meant to calculate the present value of the transactions taking into account that there is an accelerated receipt of income.

G. Maximum amount of indemnity

The third paragraph provides a final amendment to the amount of indemnity. It is not in itself a method of calculation, but it includes a limit to the amount of indemnity. The limit is the average annual remuneration. To determine the maximum sum to be paid to the commercial agent, the amount of indemnity calculated on the basis of paragraphs (1) and (2) must be compared to the commercial agent's average annual remuneration. To establish the latter, all forms of payment (not only commission) and all customers (not merely new customers or the ones generating more benefits for the principal) are to be included. If the amount of the indemnity which results from the calculation on the basis of the first two paragraphs is less than the average annual remuneration then the amount of indemnity calculated is awarded. If, however, the amount of indemnity exceeds the annual average remuneration, the latter is granted. In practice, it is quite unusual for this maximum to be reached.

H. Damages

Where the principal terminated the agency with inadequate notice the agent may decide to claim damages for the actual losses which it has suffered as a consequence of the termination of the agency: they may include the loss of clientele, investments made and costs incurred in the performance of the obligations under the agency contract, and payments to third parties, for instance employees or sub-agents. In that case the agent must prove both the loss and the fact that it was caused by the termination with inadequate notice (see IV.E.-2:303 (Damages for termination with inadequate notice)).

I. Character of the rule

This rule is a mandatory rule; the parties may not derogate therefrom to the detriment of the commercial agent.

IV.E.–3:313: Del credere clause

(1) An agreement whereby the commercial agent guarantees that a client will pay the price of the products forming the subject-matter of the contract which the commercial agent has negotiated or concluded (del credere clause) is valid only if and to the extent that the agreement:

(a) is in textual form on a durable medium;

(b) covers particular contracts which were negotiated or concluded by the commercial agent or such contracts with particular clients who are specified in the agreement; and

(c) is reasonable with regard to the interests of the parties.

(2) The commercial agent is entitled to be paid a commission of a reasonable amount on contracts to which the del credere guarantee applies (del credere commission).

COMMENTS

A. General idea

A *del credere* clause is a clause in which the commercial agent guarantees that the customer will pay to the principal the price agreed upon in the contract between the customer and the principal. Such a clause may increase the agent's liability if the customer does not perform. If the parties wish to include a *del credere* clause in the agency contract, they can only do so in textual form on a durable medium. The *del credere* clause may not extend to a general group of (or to all) customers (paragraph (1)(b)). The *del credere* clause may not unreasonably burden the commercial agent (paragraph (1)(c)). Moreover, the agent is entitled to specific compensation for the fact that the agent guarantees the customer's payments. This compensation is due from the moment of the conclusion of the contract between the principal and the client.

B. Interests at stake and policy considerations

A *del credere* clause gives the principal the possibility to control risk in the case of a customer's insolvency. This is important, especially if the agent has the authority to conclude contracts in the name of the principal. However, obviously such a clause may also imply great financial risks for the commercial agent.

In practice, the principal is frequently in a position to force the agent to accept a far-reaching liability for customers' performance. Since it is usually the principal who accepts or refuses a transaction, the agent may accept such liability for fear of losing the right to commission. Therefore, the agent needs protection. The present provision also protects the agent in the sense that the principal must pay separate commission on the contract for which the agent guarantees the payment by the customer.

CHAPTER 4: FRANCHISE

Section 1: General

IV.E.-4:101: Scope

This Chapter applies to contracts under which one party (the franchisor) grants the other party (the franchisee), in exchange for remuneration, the right to conduct a business (franchise business) within the franchisor's network for the purposes of supplying certain products on the franchisee's behalf and in the franchisee's name, and under which the franchisee has the right and the obligation to use the franchisor's tradename or trademark or other intellectual property rights, know-how and business method.

COMMENTS

A. General idea

The essential elements which characterize a franchise relationship are: a) granting the right to operate the franchisor's method of business, which mainly includes licensing the use of intellectual property rights and know-how (the business package); b) selling certain types of products (distribution contract); c) the franchisee's independence: in the franchisee's name and on the franchisee's behalf; d) (direct or indirect) financial remuneration for the franchisor.

Franchise contracts should be distinguished from ordinary distribution contracts. They differ because of the following: first, although many franchise contracts have as their object the distribution of products, this is not always the case; secondly, in a franchise contract there is always the right to operate the franchisor's business method (which notably includes transferring the use of intellectual property rights and know-how); more generally, franchise networks are characterised by a much stronger uniformity than ordinary distribution networks. In fact, in the eyes of consumers there is frequently no difference between a daughter company (or subsidiary) and a franchisee.

B. Interests at stake and policy considerations

The relevance of this Article is that it determines whether a certain contractual relationship is to be classified as a franchise. If so, the Articles in this Chapter apply. This is of particular importance in relation to the mandatory rules contained in several Articles.

Providing assistance is not considered an element of a franchising contract under the present Article. This approach differs from the one taken by European competition rules. According to European competition law, certain types of franchise agreements are exempted from falling under Article 81(1) of the EC Treaty, which prohibits agreements which are incompatible with the common market. In order to restrict the application of these exemption benefits, antitrust rules include assistance as an integral component of the business method being franchised. However, the aim of the present provision is that this Chapter applies to a broader range of franchise agreements. Hence, even when assistance is not provided, this Chapter applies.

C. Mixed contracts

Franchising agreements may draw specific elements from several types of contract: for instance, from a licence agreement relating to trademarks; a purchase or lease agreement concerning specific machinery and equipment; a distributorship agreement concerning the actual products to be marketed by the franchisee; a sales agreement to purchase the goods from the franchisor; a lease agreement concerning the premises where the business will be conducted, or an agreement on joint advertising along with the franchisor and other

franchisees for the marketing of the products. The rules on mixed contracts will apply (II.–1:108 (Mixed contracts)). The rules applicable to each relevant type of contract will apply to the corresponding part of the franchise contract. Generally speaking the franchise contract as such (i.e. the part governed by this Chapter) will regulate the framework relationship within which the other contracts will operate.

D. Types of franchise contracts

On the basis of the subject-matter of franchising three main types of franchising are usually distinguished: industrial, distribution and service franchising. In the case of an industrial franchise, the franchisee produces goods according to the instructions of the franchisor and sells them under the intellectual property rights of the franchisor, whereas in the case of a distribution franchise, the franchisee simply sells certain goods in a shop which bears the franchisor's business name or symbol. Finally, a service franchise concerns situations where the franchisee offers a service under the business name, symbol or intellectual property rights of the franchisor.

E. Franchise network

A franchise network consists of a franchisor and the group of all franchisees that operate the same business method and the existing liaison among them.

F. Competition law

Competition law may affect franchise contracts. It depends on the stipulations of the franchise agreement at stake and its economic context whether this is the case. In its *Pronuptia* decision (case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Imgard Schillgalis*, [1986] ECR 353) the ECJ held that the terms of a franchise contract concerning the confidentiality of assistance and know-how, the protection of the intellectual property rights, maintaining the identity and the reputation of the network, do not fall within the ambit of Article 81(1) EC. However, the terms of the contract that concern the partition of the market territorially do fall within the ambit of Article 81(1) EC. Having said that, a franchise agreement may be exempted if it falls within the block exemption laid down in the Commission Regulation EC No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices.

The provisions included in this Chapter only apply to franchise contracts to the extent that they are valid in the light of competition law.

IV.E.–4:102: Pre-contractual information

(1) The duty under IV.E.–2:101 (Pre-contractual information duty) requires the franchisor in particular to provide the franchisee with adequate and timely information concerning:

- (a) the franchisor's company and experience;*
- (b) the relevant intellectual property rights;*
- (c) the characteristics of the relevant know-how;*
- (d) the commercial sector and the market conditions;*
- (e) the particular franchise method and its operation;*
- (f) the structure and extent of the franchise network;*
- (g) the fees, royalties or any other periodical payments; and*
- (h) the terms of the contract.*

(2) Even if the franchisor's non-compliance with paragraph (1) does not give rise to a mistake for which the contract could be avoided under II.-7:201 (Mistake), the franchisee may recover damages in accordance with paragraphs (2) and (3) of II.-7:214 (Damages for loss), unless the franchisor had reason to believe that the information was adequate or had been given in reasonable time.

(3) The parties may not exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

In addition to the general duty for the parties in franchising to provide the other party with pre-contractual information (IV.E.-2:201 (Pre-contractual information duty)), this Article imposes a further duty on the franchisor, since it specifies the types of information which have to be provided. Paragraph (1) contains a list of items which must be disclosed. The franchisee needs to have such information in order to be able to enter the contract with full knowledge of all the relevant facts.

In addition to the remedies granted by the rule on the general duty to provide pre-contractual information, this specific provision establishes the specific remedy of liability in damages (paragraph (2)) in case the franchisor does not provide adequate and timely information on the items specified in the provision even if the lack of information does not give rise to a fundamental mistake.

B. Interests at stake and policy considerations

This duty protects the franchisee's interests. The franchisee has to make important investments without having any other possibility to obtain this qualified information. This specific duty to provide pre-contractual information is aimed at guaranteeing that the franchisee will have all the relevant and necessary information in order to commit itself with full knowledge of the relevant facts.

The main reasons for imposing a duty on the franchisor to provide the franchisee with this information may be summarized as follows. The essential information in a franchise agreement is at the disposal of the franchisor, which owns or has legal rights concerning the intellectual property rights and the know-how regarding the franchise business formula. The franchisee has no other means to collect such information since it is part of the 'business secrets' of the franchisor and is therefore confidential. Some franchisors try to attract investors by proposing that they enter a non-existent network and by promising them the possibility to operate a formula which is either non-existent or not successful. Whilst the franchisor actively asks the prospective franchisee to disclose the necessary information by means of questionnaires, the prospective franchisee is usually not in a position to direct similar questionnaires to the franchisor. As a result, the franchisee completely depends on what the franchisor wants to disclose. The unilateral imposition of standard clauses which can only be accepted on a 'take it or leave it' basis by the franchisee justifies the latter receiving prior information regarding such terms.

This disclosure rule imposes a burdensome duty on the franchisor. The franchisor may be confronted with situations where it is not certain whether all the necessary information has

been provided. It may not be possible either for the franchisor to be aware of all the facts which must be disclosed or to check whether those facts are correct.

C. Adequate information

The franchisor must provide the potential franchisee with the relevant information regarding the franchise business in order to enable the franchisee to conclude the contract with full knowledge of the relevant facts. The listing of the items in paragraph (1) is a minimum requirement: i.e. the franchisor may disclose more information but not less. In particular, relevant information normally includes:

The franchisor's company and experience. The information should include the particulars which identify the franchisor, such as the name or corporate denomination, the registered address and, where applicable, details of inclusion in the register of franchisors, as well as, in the case of a company, the share capital shown in the latest balance sheet, and details on registration in the mercantile register.

In addition, the information should also include essential information regarding the experience of the franchisor in the sector and, more specifically, regarding the franchisor's experience with the particular business formula. In principle, this information should include the date on which the franchise was launched, the main stages in the development of the business formula and the franchise network.

The relevant intellectual property rights. In principle, this information should include a certificate evidencing the granting and current validity of the title of ownership or licence for the use of the trademark and distinctive signs of the franchising company; and of possible legal proceedings against such a company, if any, with express mention in any event of the duration of the licence. The information must also indicate what will be the franchisee's rights over the intellectual property.

Here, and throughout these rules, 'intellectual property rights' includes industrial property rights, copyright and similar rights.

Characteristics of the know-how. The know-how is one of the elements contained in the business package transferred by the franchisor. It includes information concerning the franchisor's business method which is indispensable to the franchisee for the use, sale or resale of the contract products.

Commercial sector and market conditions. In principle, this information should include a general description of the franchise's sector of activity and an account of its most noteworthy features. In particular, it should include essential information regarding the state of competition, the state of demand and price development.

Franchise method. In principle, this information should include a general explanation of the system of business to which the franchise refers, the characteristics of the "know-how" and the assistance to be provided by the franchisor, as well as an estimate of the investments and expenses which are necessary for conducting a typical business. If the franchisor is to provide the potential individual franchisee with sales forecasts or trading results, these should be based on experience or studies and should be sufficiently justified.

Structure and extent of the franchise network. In principle, this information should include the form of the organisation of the franchise network and the number of establishments, distinguishing those exploited directly by the franchisor from those operated by other franchisees, the place where they are located and the number of franchisees which have recently ceased to belong to the network, stating whether such a cessation occurred due to the expiry of the contractual term or due to other causes for termination.

Fees, royalties and other periodical payments. In practice, parties generally agree that financial remuneration comprises two elements: the initial fee and ongoing periodical payments. Before entering into the agreement the franchisees must be aware of the conditions of payment, especially of those periodical fees which will be determined by the franchisor at a later stage. Information should be given regarding the criteria for determining the periodical payments to be made during the whole duration of the contractual relationship.

The terms of the contract. In principle, this information should include the rights and obligations of the respective parties, the duration of the contract, the fee system, the conditions for termination and, if applicable, for the renewal thereof, economic considerations, exclusivity agreements, and restrictions on the free disposal of the business by the franchisee.

D. Character of the rule

This rule is mandatory; the parties are not free to agree otherwise.

E. Remedies

This Article provides the franchisee with the specific remedy of damages (paragraph (2)), when the franchisor does not provide adequate and timely information on the items included in the specific list even if the information does not give rise to a mistake which would provide a ground for avoidance of the contract, unless the franchisor had reasons to believe that the information was adequate or given within a reasonable time.

IV.E.-4:103: Co-operation

The parties to a contract within the scope of this Chapter may not exclude the application of IV.E.-2:201 (Co-operation) or derogate from or vary its effects.

COMMENTS

Although in general the obligation of co-operation is non-mandatory there is an exception in the case of franchise contracts. The justification for this exception is the particularly close and collaborative nature of the relationship. Co-operation is of the essence of the relationship.

Section 2: Obligations of the franchisor

IV.E.-4:201: Intellectual property rights

(1) The franchisor must grant the franchisee a right to use the intellectual property rights to the extent necessary to operate the franchise business.

(2) The franchisor must make reasonable efforts to ensure the undisturbed and continuous use of the intellectual property rights.

(3) The parties may not exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

Under paragraph (1) of this provision, the franchisor is obliged to grant the franchisee the licence to use the intellectual property rights related to the franchise business. It necessarily implies that the franchisor owns or has legal rights to license these rights and that there are no third parties with better rights over the intellectual property who may disturb the use of the proprietary rights by the franchisee.

Under paragraph (2), the franchisor is bound to undertake reasonable efforts to prevent and to rectify situations where third parties claim that they have a better right over the intellectual property and consequently attempt to disturb the use of the rights by the franchisee.

Whilst paragraph (1) imposes on the franchisor the obligation to attain a certain result, which is to license the use of the property rights to the extent necessary to operate the franchise business, paragraph (2) merely obliges the franchisor to observe due diligence in providing an adequate response when there is an action, claim or proceeding brought or threatened by a third party concerning such intellectual property rights.

B. Interests at stake and policy considerations

The licensing of intellectual and industrial property rights is the cornerstone in the proper functioning of the franchise business method. Consumer recognition of and confidence in the product identified by the trademark is the lifeline of a successful franchise system. In fact, this is the main reason for franchisees to be attracted by the franchisor's system of doing business.

Since it is the selling of products during the entire duration of the franchise which forms the object of the exploitation of the intellectual and industrial property rights it is essential for the franchisee to be provided with the necessary licences in order to be able to benefit from the attraction of the trademark and it is equally crucial that the franchisor ensures the undisturbed and continued use of these rights.

The franchisor is interested in the expansion of its business and image. Therefore the franchisor has to ensure that the members of the network utilise the trademarks and other signs which identify the business and also has to prevent and resolve situations where third parties intend to disturb the use of such rights. The franchisor must be in the lead in any action, claim or proceeding brought or threatened by a third party with regard to the intellectual property rights involved in the franchise business.

C. Granting intellectual property rights

The exact meaning of the expression “grant ...a right to use the intellectual property rights” depends on the intellectual property rules in each legal system. Neither ownership of such rights nor registration is always a prerequisite for being able to assign them or to grant a right to use. Thus, the franchisor may be the owner or merely have the legal rights to grant or transfer the intellectual property rights involved in the franchise relationship.

D. To the extent necessary to operate the franchise business

These words refer to the package of industrial and intellectual property rights relating to trademarks, trade names, shop signs, logos, insignia, utility models, designs, copyrights and related rights, software, drawings, plans or patents held by the franchisor for the operation of the franchise business.

E. Undisturbed and continuous use of intellectual property rights

The franchisor is required to make reasonable efforts to guarantee the undisturbed and continuous use of the relevant intellectual property rights (paragraph 2). In assessing what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved should be taken into account. (See the definition of “reasonable” in Annex 1.)

The franchisor’s intellectual property rights are protected against abuse by the franchisee. Apart from the rules in intellectual property law and the licence agreement, the franchisee is under an obligation to strictly limit the use of the rights to the operation of the franchised business and in the manner provided for by the franchisor (see IV.E.–4:303 (Business method and instructions)). Moreover, the franchisee is to be identified as a mere licensee of such rights.

The obligation to guarantee the undisturbed and continuous use of these rights may have different consequences depending on the national situation: e. g. the obligation to fulfil validity requirements according to national legislation (for example, renewing registration).

F. Character of the rule

This is a mandatory rule; the parties are not free to agree otherwise.

IV.E.–4:202: Know-how

(1) Throughout the duration of the contractual relationship the franchisor must provide the franchisee with the know-how which is necessary to operate the franchise business.

(2) The parties may not exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

One of the franchisor’s main obligations is to provide the franchisee with the relevant know-how, by means of operational manuals, or, in the case of general knowledge and experience, through ongoing assistance.

Know-how is to be provided as part of the initial package to enable the franchisee to start the operation of the business, but also during the entire duration of the franchise in so far as necessary to operate the business activities correctly.

According to the present Article the franchisor must provide the franchisee with the necessary know-how during the entire period of the contractual relationship. This implies that if during that period the know-how is changed or updated, the franchisor must provide the franchisee with the updated know-how.

B. Interests at stake and policy considerations

Know-how plays a central role in the franchise system. The franchisor's know-how is, together with the appeal of the trademark, the most interesting value which the franchisor has to offer to a franchisee. As a result, even relatively inexperienced entrepreneurs can start a sophisticated business concept. In addition, the franchisor and the other franchisees have an interest in the franchisee being provided with relevant know-how from the outset in order to maintain the standard and reputation of the whole franchise chain. This guarantees that the same method of exploitation will be used, which ensures the maintenance of the common image and reputation of the network and therefore eventually benefits both parties in franchising. If, within the franchise period, the operational system has to be modified, the franchisee must be made aware of such changes. In that way the franchisee will be able to adapt the operational method and consequently continue the correct operation of the business.

C. Necessary know-how

Know-how is defined by art. 1(f) of EC Regulation No. 2790/1999 as a package of non-patented practical information, resulting from experience and tested by the supplier, which is secret, substantial and identified. In this context "secret" means that the know-how, as a body or in the precise configuration and assembly of its components, is not generally known or easily accessible; "substantial" means that the know-how includes information which is indispensable to the buyer for the use, sale or resale of the contract products; "identified" means that the know-how must be described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality.

Necessary know-how includes technical information, financial data, advice on site selection and the layout of the premises, the provision of start-up materials and any other specifications specifically relating to the system and the intellectual property rights and the utilisation of them contained in the operating manuals or the agreement.

D. Regularly reviewed know-how

Any modification of the operational method has to be communicated promptly to the franchisee. This is mainly done by updating the operational manuals and assisting the franchisee in adapting to the changes.

E. Protection of know-how

Protection of the franchisor's know-how from misuse by franchisees and competitors is taken care of by the provision which imposes on the franchisee the obligation to follow the business method and instructions (IV.E.-4:303 (Business method and instructions)) and by the confidentiality obligation in the general chapter (IV.E.-2:203 (Confidentiality)).

F. Relation to obligation to inform

The communication of know-how is a very particular manifestation of the franchisor's obligation to inform under IV.E.-4:205 (Information during the performance). It is considered to be one of the main obligations for the franchisor since it concerns the indications as to how the business method is to be operated which are vital to allow the franchisee to exploit the franchise business. Such information is confidential because it forms part of the business secrets of the franchisor.

These specific characteristics justify that the obligation to communicate know-how, although, strictly speaking, contained in a more general obligation to inform, is formulated here as a specific obligation in a separate provision.

G. Character of the rule

This is a mandatory rule; the parties are not free to agree otherwise.

IV.E.-4:203: Assistance

(1) The franchisor must provide the franchisee with assistance in the form of training courses, guidance and advice, in so far as necessary for the operation of the franchise business, without additional charge for the franchisee.

(2) The franchisor must provide further assistance, in so far as reasonably requested by the franchisee, at a reasonable cost.

COMMENTS

A. General idea

Providing the franchisee with the right to use the intellectual property rights and with the know-how concerning the franchisor's method is generally not sufficient to allow the franchisee to successfully manage the business. In addition to such information, the franchisee may need assistance from the franchisor on using the information concerned in practice.

Paragraph (1) imposes on franchisors an obligation to assist the franchisees in order to provide them with the necessary support in commencing the operation of the business (initial assistance) and to solve problems which may arise throughout the duration of the relationship regarding the operation of the business concept (ongoing assistance). The franchisor is obliged not only to provide assistance actively but also to respond to the franchisee's demands for assistance when the requested assistance is necessary to enable the franchisee to operate the business correctly.

The content of the obligation to assist is specified in the wording of the Article: assistance is provided in the form of training courses, guidance and advice.

Paragraph (1) makes it clear that the necessary assistance is to be provided without any additional cost for the franchisee. It means that the payment to be made in exchange for assistance is deemed to be included in the payments made by the franchisee for the right to operate the franchisor's business method.

Paragraph (2) concerns the franchisor's obligation to respond to requests from the franchisee for further assistance. The franchisor is obliged to provide such assistance when the request is reasonable. The franchisor can charge the franchisee for the provision of further assistance in so far as the additional cost is reasonable.

B. Interests at stake and policy considerations

This provision is mainly aimed at safeguarding the franchisee's expectations concerning the system which the franchisee has entered. Franchisees need certainty as to the proper way in which to conduct the franchised business, and it is only the franchisor which can provide this.

On the other hand, the obligation to assist and to be responsive to requests for further assistance in so far as they are reasonable is a burden imposed on the franchisor since it requires the franchisor continuously to keep up with the activities of the franchisees and to collaborate actively with the members of the network during the entire period of the franchises in order to guarantee that they operate the business correctly.

However, by providing active assistance to the franchisees, the franchisor guarantees a uniform exploitation throughout the network which is in the interest of all the franchisees, and ultimately of the franchisor as well.

C. Necessary assistance

Assistance is to be considered as a broad concept. It comprises the organisation of training courses, the provision of advice based on general knowledge and experience, e. g. advice on real estate and financial planning and visits to premises, in so far as is required in order to allow the franchisee to adequately operate the franchise business.

Assistance on site may include additional training (usually in an area of weakness or with respect to a newly introduced service, product, method or technique), the identification of the franchisee's successes and weaknesses, the establishment of strategies to attain the goals which have been set, conversations with employees and customers, and technical assistance.

D. Responsive to reasonable requests for further assistance

Standard assistance from the franchisor may not suffice to provide all franchisees with sufficient certainty concerning the method by which to conduct the business. Franchisees may need additional input from their franchisor. Through the present provision franchisees are granted the right to demand further assistance from the franchisor at a reasonable cost, in so far as the requests are reasonable. To assess whether requests are reasonable, the nature and the purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved should be taken into account. (See definition of "reasonable" in Annex 1.) Normally, requests which are meant to achieve guidance which serves to meet the specific needs of the franchisee in order to guarantee the adequate operation of the business, will be considered reasonable.

E. Without additional cost

Necessary assistance, along with the intellectual property rights and know-how, are part of the business package which the franchisor must transfer to the franchisee in exchange for direct or indirect financial remuneration. Therefore, such remuneration covers the provision of assistance which is necessary for the operation of the business. Only demands for specific

assistance which is not necessary in general terms, but which may be necessary for the particular franchisee in order to meet the franchisee's needs as regards the adequate operation of the business and the maintenance of the quality standards, could lead to extra costs for the franchisee, in so far as the additional cost is reasonable.

IV.E.–4:204: Supply

(1) When the franchisee is obliged to obtain the products from the franchisor, or from a supplier designated by the franchisor, the franchisor must ensure that the products ordered by the franchisee are supplied within a reasonable time, in so far as practicable and provided that the order is reasonable.

(2) Paragraph (1) also applies to cases where the franchisee, although not legally obliged to obtain the products from the franchisor or from a supplier designated by the franchisor, is in fact required to do so.

(3) The parties may not exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The present Article is meant to establish (under paragraph (1)) that in the case that the franchisee is forced to obtain its goods or services only from the franchisor or from a supplier appointed by the franchisor, the franchisor must guarantee that the orders for the supply of the franchisee are met within a reasonable time, whether the supplier is the franchisor or a third party designated by the franchisor, in so far as the demands for supply are reasonable.

This provision also concerns cases where parties do not explicitly agree on an exclusive purchasing obligation for the franchisee but where the franchisee has recourse, in fact, to no other source of supply than the one provided by the franchisor or by the suppliers designated by the franchisor – e. g. when only the products supplied by the franchisor and suppliers designated by the franchisor meet the quality standards required. According to paragraph (2), the franchisor is also obliged to guarantee the delivery of the products to the franchisee within a reasonable time when there is de facto exclusivity.

B. Interests at stake and policy considerations

It is a very common practice in franchising that parties agree on an exclusive purchasing clause in favour of the franchisor. This obligation means that the franchisee's needs for supply can only be met either by the franchisor or by designated suppliers.

Exclusive purchasing obligations are justified when they aim to assure that the products distributed within the franchise network fulfil the objective quality standards of the franchisor's network. However, such a constraint is likely to have very negative consequences for the franchisee when the franchisor or the designated suppliers refuse to meet the franchisee's orders for supply, restrict the amount to be delivered or delay delivery without any business-related justification. This provision is meant to reduce these negative effects by assuring that the decision whether or not to supply the franchisee is not at the sole discretion of the franchisor or the designated suppliers.

This rule may be deemed a very burdensome obligation since the franchisor is obliged to guarantee that the franchisee is provided within a reasonable time with the supplies ordered, even when the counterpart of the franchisee in the sales contract is not the franchisor but another supplier designated by the franchisor. The rationale of this rule is that when the franchisee grants exclusivity to the franchisor, the former should obtain some advantage in return.

The obligation is, however, limited to guaranteeing the delivery of *reasonable* orders. The reasonableness test is meant to protect the supplier against orders for supply which demand the delivery of products which are not actually needed to enable the franchisee to operate the business. These are orders which exceed what the franchisee would normally order according to the contract and to the franchisee's actual needs for supply. Furthermore, the franchisor is only obliged to guarantee delivery in so far as it is practicable to do so (for the franchisor or for the designated suppliers) taking into account the suppliers' supply capacity.

A prompt delivery of the products is eventually beneficial for both parties. An adequate supply permits the franchisee to continue with the operation of the distribution business whilst at the same time it prevents temptations, on the side of the franchisee, to purchase competing products in order to fulfil its need for supply. Such a reaction of the franchisee would be certainly risky for the franchisor and the other franchisees because it may alter the uniform quality of the products within the franchise network.

C. Designated suppliers

As a counterpart of the franchisor's prerogative to restrict the franchisees' freedom of business by compelling them to purchase the products from selected suppliers, the franchisor is obliged to guarantee that the designated suppliers provide the franchisee within a reasonable time with the products which the franchisee orders, provided that these orders are reasonable.

D. Practicability

The franchisee is entitled to demand the fulfilment of the supply orders in so far as it is practicable for the franchisor or the designated suppliers to fulfil such demands in view of their actual supply resources. Supply would also be impracticable if the supplier encounters an insuperable obstacle to perform or the fulfilment of such an obligation would cause inconvenience or expenses on the supplier's side which are substantially disproportionate to the demands of the franchisee.

E. Reasonable order

To assess whether an order is reasonable, the nature and the purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved must be taken into account. (See the definition of "reasonable" in Annex 1.) In this respect it is particularly relevant whether the franchisee seeks delivery of products of the quality, quantity and modality which is required by the franchise contract and which enable the franchisee to operate the distribution activities adequately, and whether the orders fall within the scope of the franchising contract, i. e. the franchisee is to be provided with the products which are the subject of the franchise. Special market conditions could justify demands for supply which exceed the franchisee's normal requests.

F. De facto exclusivity

Paragraph (2) concerns the situation where the parties have not agreed explicitly upon exclusive purchasing obligations, but where there is an exclusivity *de facto*. Such is the case when the franchisee has in fact no possibility to be supplied by any other supplier because e. g. the other suppliers do not meet the quality standards imposed by the franchisor or it is not possible to find the products which are the subject of the franchise in the market. Other examples are situations where better prices of the products offered by the franchisor have led the franchisee to purchase exclusively from the franchisor; or where the franchisee has been buying exclusively from the franchisor from the start of their relationship and in fact an exclusive sales relationship is the result.

G. Character of the rule

This is a mandatory rule; the parties are not free to agree otherwise.

IV.E.-4:205: Information by franchisor during the performance

The obligation to inform requires the franchisor in particular to provide the franchisee with information concerning:

- (a) market conditions;*
- (b) commercial results of the franchise network;*
- (c) characteristics of the products;*
- (d) prices and terms for the supply of products;*
- (e) any recommended prices and terms for the re-supply of products to customers;*
- (f) relevant communication between the franchisor and customers in the territory; and*
- (g) advertising campaigns.*

COMMENTS

A. General idea

The obligation to inform imposed by IV.E.-2:103 (Information during the performance) is further elaborated by this Article.

The Article includes an obligation for the franchisor to provide information (without being requested by the franchisee) and specifies the types of information that should normally be disclosed. The obligation to inform comprises more than communicating know-how or providing assistance. It refers to all the relevant data concerning the exploitation of the franchised business, such as general information concerning the market, research projects, improvements made to the business method or commercial results. The list of required information is not exhaustive.

In certain circumstances it may be reasonable for the franchisor to charge the franchisee for the specific information to be provided.

B. Interests at stake and policy considerations

Both parties have an interest in being kept informed concerning facts and developments which are relevant to their performance. It can make their performance easier and more successful.

The reciprocal exchange of information throughout the franchise network also benefits the whole network: it will lead to a continuous improvement of the business method.

This provision is aimed at guaranteeing that the franchisee who is obliged to conduct the franchise business according to the concept of the franchisor, is provided with all the relevant information regarding the franchisor's business method which will allow the proper performance of the franchisee's obligations. This obligation also serves to meet the interests of the franchisor, since by providing such information the franchisor guarantees that all franchisees operate the business in a uniform manner and meet the quality specifications.

C. Necessary information

The franchisee must be provided in due time with all the information which the franchisee needs for the proper operation of the franchise business (IV.E.-2:103 (Information during the performance)).

In particular, the information to be provided normally includes the disclosure of the following features:

Market conditions. This mainly regards up-dated information concerning the state of competition and the state of demand.

Commercial results of the franchise network. The welfare and success of the franchisor's method requires that all the members of the network operate the system in a uniform manner. It means that the achievement of the expected profit by a franchisee does not only depend on its isolated efforts to operate the franchise outlet but also depends on the business efforts of the other franchisees. Therefore, the individual business activity of each franchisee has an impact on the business results of the other members. The information on whether the other members are achieving positive or negative commercial results is an indicator of whether the system is working adequately.

This obligation imposes indirectly an obligation on each franchisee to inform the franchisor concerning the individual commercial results, but this is in any case the common practice in franchising since the ongoing payments are generally calculated on the basis of the achieved benefits of each franchisee.

Characteristics of the products. Franchisees are intermediaries in the distribution channel since they undertake the obligation to pass on the products of the franchisor to customers. The relevant information regarding such products is in the hands of franchisors. In fact, it is for the franchisor to establish the quality standards which are to be met by the products offered to consumers. An adequate performance of the contractual obligations of franchisees requires adequate and accurate knowledge concerning the products and services offered to third parties during the time the franchisee carries out its task as a distributor. Therefore the franchisor should provide the franchisee with updated information on the characteristics of the goods and services which are to be distributed.

Prices and conditions for the sale of products. Franchise contracts generally contain a provision by which the seller (franchisor) agrees with the buyer (franchisee) on the terms under which the sale of the products is to be carried out. Among them is the sales price. Due

to the generally long-term character of franchise agreements, these conditions may change during the course of the relationship. If such is the case it is for the franchisor, as the supplier of the products and consequently the one with access to such an information, to inform the franchisee.

Any recommended prices and terms for the resale of products. In addition to the sales contract concluded between franchisor and franchisee, there is another sales contract. This is the sales contract concluded between the franchisee and the customer for the resale of products. Usually franchisors recommend which prices are to be charged to the customer. The franchisees will typically respect such recommendations in order to ensure a competitive position in the market and a certain harmonisation with the price policy and the advertising campaigns throughout the network which eventually benefits all franchisees.

Relevant communication with customers in the territory. Any contact between the franchisor and customers belonging to the territory where the franchisee's outlet is located which can be relevant as to the operation of the business by the individual franchisee (e. g. preferences of customers, expected changes in demand) is to be communicated to the franchisee.

Advertising campaigns. The success of franchisees in conducting the business depends on the maintenance of the reputation of the network which is made known to customers through advertising. The franchisor is under an obligation to ensure an adequate advertising strategy and to coordinate the promotion activities of the members of the network (IV.E.–4:207 (Reputation of network and advertising)). Such an obligation necessarily implies giving information to the franchisees regarding the advertising initiatives taken by the franchisor, notably regarding those which do not involve the participation of franchisees on a local level.

D. No formalities

There is no formal requirement as to the way in which this obligation must be performed, e. g.: in writing. Nevertheless, in practice such information will generally be provided in writing.

IV.E.–4:206: Warning of decreased supply capacity

(1) When the franchisee is obliged to obtain the products from the franchisor, or from a supplier designated by the franchisor, the franchisor must warn the franchisee within a reasonable time when the franchisor foresees that the franchisor's supply capacity or the supply capacity of the designated suppliers will be significantly less than the franchisee had reason to expect.

(2) For the purpose of paragraph (1) the franchisor is presumed to foresee what the franchisor could reasonably be expected to foresee.

(3) Paragraph (1) also applies to cases where the franchisee, although not legally obliged to obtain the products from the franchisor or from a supplier designated by the franchisor, is in fact required to do so.

(4) The parties may not, to the detriment of the franchisee, exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

This provision concerns situations where the franchisee is obliged to purchase the contract products only from the franchisor or from other suppliers designated by the franchisor. This rule establishes that in such cases the franchisor must warn the franchisee when the franchisor foresees an important decrease in the franchisor's supply capacity or in the supply capacity of the authorised suppliers. This obligation does not concern decreases in the supply capacity of the franchisor or authorised suppliers which can reasonably be expected by the franchisee. However, it is concerned with situations where the supply capacity of the suppliers turns out to be significantly less than what the franchisee had reasons to expect.

Paragraph (2) provides that the franchisor is presumed to foresee changes which the franchisor could reasonably be expected to foresee.

Paragraph (3) extends the obligation for the franchisor in franchise relationships where, even though the parties have not agreed on a contractual obligation to exclusive purchasing, the franchisee is, in fact, obliged to buy on an exclusive basis from the franchisor or from authorised suppliers.

B. Interests at stake and policy considerations

An exclusive purchasing obligation implies that the franchisee is not allowed to find sources of supply other than the one provided by the franchisor or the designated supplier. Eventually, this means that the franchisee entirely depends on the supply capacity of the franchisor and the authorized suppliers. Therefore, even when the franchisor or the authorised suppliers cannot supply the products involved in the franchise business, the franchisee cannot approach other suppliers.

This provision aims to protect the franchisee in such situations. It aims to avoid situations where it is not possible for the franchisee to continue operating the business because the suppliers cannot deliver the required supplies due to a decrease in the supply capacity. Due to the franchisor's warning, the franchisee will be able to adapt the new availability of supplies to the demand of customers. The franchisor must warn the franchisee within a reasonable time, so that the latter may react promptly.

This obligation may be deemed burdensome for the franchisor. However, this strict obligation is justified, since the franchisor is the one who imposes on the franchisee the obligation to purchase exclusively from the selected suppliers. In addition, this obligation is not unreasonably burdensome since the franchisor does not have to provide the franchisee with the reasons why the supply capacity will change and since there are two limits to the obligation of the franchisor: (1) the decrease in the supply capacity must be foreseen (or, taking the presumption into account, at least reasonably foreseeable) and (2) the decrease cannot reasonably be expected by the franchisee.

This obligation to warn is also in the franchisor's interests. If the warning is given a sufficient time in advance, the franchisee will be able to adapt to the new supply availability and find solutions which avoid the disappointment of customers when they are not provided with the

products they expect. Consequently the franchisor's reputation will not be negatively influenced.

C. Supply capacity

The supply capacity of the franchisor or of the designated suppliers concerns the availability of products of the type which the franchisee has ordered or usually orders.

D. Designated suppliers

The franchisor is obliged, according to this provision, to warn the franchisee when the franchisor foresees that the supply capacity of the selected suppliers will be significantly less than what the franchisee had reason to expect.

E. Reasonable time

In principle, the warning must be given a sufficient time in advance in order to allow the franchisee to react and adapt to the new supply availability. To assess what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved should be taken into account. (See the definition of "reasonable" in Annex 1.)

F. Significant decrease

The franchisor must warn the franchisee when the supply capacity will be significantly less than expected. It follows that no obligation arises in the case of a minor or temporary obstacle to supply.

G. Expectations of the franchisee

The franchisee will normally expect to be provided with the amount of products purchased from the franchisor or the designated suppliers and which corresponds with the franchisee's needs for supply with a view to an adequate operation of its business.

H. De facto exclusivity

Paragraph (3) equates situations where the parties have explicitly agreed on exclusive purchasing obligations with situations where there is no explicit agreement, but nonetheless there is a situation of actual exclusivity. This is the case when the franchisee has in fact no possibility to buy from other suppliers because no one meets the quality standards imposed by the franchisor or because it is impossible to find the products which are the subject of the franchise in the market.

I. Character of the rule

This is a mandatory rule; the parties are not free to agree otherwise.

IV.E.-4:207: Reputation of network and advertising

(1) The franchisor must make reasonable efforts to promote and maintain the reputation of the franchise network.

(2) In particular, the franchisor must design and co-ordinate the appropriate advertising campaigns aiming at the promotion of the franchise network.

(3) The activities of promotion and maintenance of the reputation of the franchise network are to be carried out without additional charge to the franchisee.

COMMENTS

A. General idea

Under this provision the franchisor must make reasonable efforts to promote and maintain the network. These efforts include maintaining the good reputation of the intellectual property rights related to the franchise business. In the same manner it requires the observation of due diligence in assuring that the know-how is up-dated and is in conformity with the relevant circumstances. The maintenance of such a common reputation also depends on the extent to which uniformity is preserved. Such uniformity is achieved when all the members within the network follow the common guidelines for conducting the business. All these aspects, pursuant to this provision, fall under the franchisor's control. In addition, the franchisor must actively promote the business.

Paragraph (2) stresses the importance of advertising as a crucial activity in maintaining the good reputation of the network. Since the success of a franchise business largely depends on the appeal of the formula and the trademark, the franchisor must make reasonable efforts to promote the franchise chain through advertising campaigns. The advertising efforts, the costs of which are to be borne by the franchisor (paragraph (3)), point to the activities of design and coordination of the campaigns followed by the members of the network.

This Article does not include advertising campaigns which are initiated by the franchisee as an independent entrepreneur and which are intended to promote the franchisee outlet on a local level.

B. Interests at stake and policy considerations

The reputation and image of the franchisor's method of business with respect to consumers attract businesses which are interested in adopting the same formula in order to have a high possibility of making a profit. The economic profitability of the franchise business for both franchisor and franchisee depends on the maintenance of the good reputation and image of the network towards consumers. Therefore, both parties' activities will be aimed at maintaining the good reputation of the network.

Since the franchisor is in the position to exercise control over the intellectual property rights and know-how related to the business concept and especially over the activities of the members of the network, it is for the franchisor to devote reasonable efforts to promote and maintain the good reputation of the network, especially by guaranteeing a uniform operation of the business formula by the franchisees in the network.

The maintenance of the good reputation of the network necessarily requires an adequate promotional activity to be carried out by the franchisor in co-ordination with all its franchisees to guarantee a common image in the eyes of the public.

This obligation, which may seem very burdensome for franchisors, may not in practice have such a negative impact. What generally occurs is that franchisors are reluctant to grant a great deal of discretion to franchisees in promoting the franchise business. The reason for this is that a uniform and reputable image of the system is normally made known to customers

through advertising. Therefore, contracts generally contain clauses whereby the franchisor undertakes the obligation to control promotional activities.

C. Reasonable efforts

The franchisor is required to make reasonable efforts to guarantee the maintenance of the good reputation of the franchise network. To assess what is reasonable the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved, among other things, should be taken into account. (See the definition of “reasonable” in Annex 1.)

D. Appropriate advertising campaigns

Appropriate advertising campaigns mainly refer to advertising campaigns on an international, national or regional level which are aimed at promoting the franchisor’s business on a general level. The initiative is to be taken by the franchisor, who is furthermore obliged to guarantee that all members of the network uniformly follow the campaigns.

Some of the advertising campaigns may require the participation of franchisees on a local level. The franchisee must participate on a local level in the advertising campaigns launched by the franchisor in so far as these campaigns are reasonable.

E. Without additional cost

Under the Article, the costs of promoting and maintaining the reputation of the network are to be paid by the franchisor. In other words, the price that the franchisee has to pay as a contribution to the advertising campaigns launched by the franchisor is deemed to be included in the periodical payments made by the franchisee. This is designed to prevent uncontrolled and unilateral inflation of royalties in the guise of advertising costs. It therefore aims to protect the franchisee in that the franchisee does not have to pay for the advertising unless the contract explicitly says so and the franchisee was properly informed of this during the pre-contractual stage.

The exception to this rule is for those situations where the franchisee must participate on a local level in the advertising campaigns launched by the franchisor. If that is the case, the costs of local advertising are to be covered by the franchisee provided that the price is reasonable.

Section 3: Obligations of the franchisee

IV.E.–4:301: Fees, royalties and other periodical payments

(1) The franchisee must pay to the franchisor fees, royalties or other periodical payments agreed upon in the contract.

(2) If fees, royalties or any other periodical payments are to be determined unilaterally by the franchisor, II.–9:105 (Unilateral determination by a party) applies.

COMMENTS

A. General idea

In practice, the parties to a franchise contract generally agree on an initial payment, which is viewed as an admission fee for entry to the franchise network. It is normally a fixed amount which essentially covers the franchisor's initial training and recruitment costs. In addition, parties further agree on periodical payments or royalties, which are to be paid during the whole duration of the contractual relationship, in exchange for the continuous exploitation of the business, ongoing assistance provided by the franchisor and so on. This provision spells out the franchisee's obligation to pay these fees, royalties and periodical payments.

However, where the contract states that such fees are to be determined (at a later stage) by the franchisor unilaterally and the franchisor's determination of the price is unreasonable, a reasonable price is substituted by law in accordance with II.-9:105 (Unilateral determination by a party).

B. Interests at stake and policy considerations

In many franchise relationships periodical fees cannot be established at the moment of concluding the contract for its whole duration. Sometimes it is not even possible to establish an objective mechanism beforehand. In those cases it may be reasonable to accept the validity of a contract which leaves the determination of a term, even one as important as the periodical fee, to one party, very often the franchisor. However, the law must closely monitor the use which the franchisor makes of such a discretionary power, especially in the case of franchise contracts where the franchisee is frequently heavily dependent (as a result of extensive investments) on the continuity of the contractual relationship.

This Article provides the franchisee with strong protection in the case of an abuse by the franchisor of its discretionary power: the legal effect is not the invalidity of the unreasonable term (and maybe as a result the invalidity of the whole contract) but the substitution of a reasonable term by law. If the franchisor does not want to continue the contractual relationship on these reasonable terms, it is left with no other choice but to end the contract. However, in that case it will have to respect the rules contained in Chapter 1. In particular, it will have to give reasonable notice.

Such strong protection is necessary in order to avoid the situation where a franchisor can effectively end the franchise without having to give reasonable notice simply by unreasonably raising the fee, thus forcing the franchisee to end the relationship.

C. Relation to other provisions

This Article applies – specifically concerning fees, royalties or any other periodical payments in franchise contracts – the rule in II.-9:105 (Unilateral determination by a party) concerning the price and any other contractual term in any contract. This Article aims to ensure that any fees, royalties or any other periodical payments which are to be established unilaterally by the franchisor are covered by the policy laid down in that general provision. An additional justification for the presence of this specific Article is that the unreasonable unilateral determination of fees is one of the most recurrent problems in franchise relationships. Therefore, a clear and specific rule is appropriate.

D. Calculation of royalties and periodical payments

Royalties and periodical payments are frequently calculated on the basis of the franchisee's quarterly gross sales. Since these payments are to be made on a periodical basis and during the entire course of the relationship, they are normally increased by the franchisor to adapt the price to inflation and other circumstances (for example, an increase in production costs, an increase in the value of the shares of the franchise company, improvements to the system) and the franchisee. The contract may provide for a mechanism or criteria which determine variations in the amount which is periodically due.

IV.E.-4:302: Information by franchisee during the performance

The obligation under IV.E.-2:202 ((Information during the performance) requires the franchisee in particular to provide the franchisor with information concerning:

- (a) claims brought or threatened by third parties in relation to the franchisor's intellectual property rights; and*
- (b) infringements by third parties of the franchisor's intellectual property rights.*

COMMENTS

A. General idea

As a counterpart to the franchisor's obligation to make reasonable efforts to ensure the undisturbed use of intellectual property rights regarding the operation of the franchise business, under this provision the franchisee is required to inform the franchisor if the franchisee becomes aware of any claim brought or infringement made by a third party regarding the franchisor's intellectual property rights – it will mainly concern claims and infringements by third parties located in the local market where the franchisee operates. This list of information obligations is not exhaustive.

B. Interests at stake and policy considerations

Both parties have an interest in being kept informed concerning facts and developments which are relevant to their performance. It can make their performance easier and more successful. Reciprocal exchange of information throughout the franchise network also benefits the whole network: it will lead to a continuous improvement of the business method.

However, the present provision moderates the burden of the obligation to inform for franchisees since in most cases only this information is relevant to the proper functioning of the franchising network.

IV.E.-4:303: Business method and instructions

(1) The franchisee must make reasonable efforts to operate the franchise business according to the business method of the franchisor.

(2) The franchisee must follow the franchisor's reasonable instructions in relation to the business method and the maintenance of the reputation of the network.

(3) The franchisee must take reasonable care not to harm the franchise network.

(4) The parties may not exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The franchisee is under an obligation to conduct its business in accordance with the franchisor's method. This method is communicated to the franchisee through a business package that comprises intellectual property rights, know-how and assistance. The present provision is aimed at guaranteeing a uniform operation of the franchise business and the protection of the franchisor's business values. In other words, the franchisee has not only a right to obtain intellectual property rights, know-how and assistance from the franchisor but also an obligation to use the intellectual property rights, know-how and assistance according to the franchisor's business method.

Moreover, the franchisee must follow the instructions given by the franchisor regarding the method by which to conduct the franchise system, in so far as such instructions are reasonable in order to guarantee the correct functioning of the system.

B. Interests at stake and policy considerations

This rule aims to guarantee that the intellectual property rights, the know-how and the knowledge provided through assistance are followed by all franchisees within the network. Such protection of the network is essential, both for franchisors and franchisees, who depend on the economic strength of the trademark and who share a common interest in protecting the image and reputation of the franchise network.

In addition to the general obligation to follow the franchisor's business method, the franchisee is also required under paragraph (2) to follow indications which may frequently be given by the franchisor during the relationship. The maintenance of the quality standards and uniformity of the franchise network may not be attainable unless the franchisee follows such instructions.

Such an obligation is to be measured against the interest of the franchisee in managing its business as an independent entrepreneur. As such, it is obliged to follow the method and instructions of the franchisor provided that they do not hinder its independence.

C. Instructions

Apart from being reasonable the instructions must also be necessary to guarantee the maintenance of the quality standards required by the franchisor's method; they must not change the method articulated through intellectual property rights, know-how and assistance and they must not hinder the legal status of the franchisee as an independent entrepreneur – the franchisee may arrange its activities and use its time as it thinks fit.

D. Reasonable care not to harm the franchise network

Although it is in the franchisee's own interests to ensure the reputation of the franchise network, this provision stresses the importance for the welfare of the franchise network to avoid any misbehaviour on the part of franchisees which may result in damaging the image of the franchise system. Consequently, the franchisee is expressly required to take reasonable care not to harm the network.

E. Character of the rule

This is a mandatory rule; the parties are not free to agree otherwise.

IV.E.-4:304: Inspection

(1) The franchisee must grant the franchisor reasonable access to the franchisee's premises to enable the franchisor to check that the franchisee is complying with the franchisor's business method and instructions.

(2) The franchisee must grant the franchisor reasonable access to the accounting books of the franchisee.

COMMENTS

A. General idea

This provision imposes on the franchisee the obligation to allow the franchisor to enter the franchisee's premises to check whether the franchisee is complying with the quality standards of the franchisor's business method and with the instructions given by the franchisor regarding the operation of the franchised business.

Under paragraph (2), the franchisee is also required to allow reasonable access to its accounting books.

B. Interests at stake and policy considerations

Inspection is an effective method for the franchisor to check whether the franchisee manages the franchise business in accordance with the guidelines which are provided by the franchisor and which must be respected by all franchisees in order to maintain the common image and reputation of the network. Thus, it is indirectly beneficial for the other franchisees.

The franchisor is granted the right to have reasonable access to the accounting books of the franchisee in so far as this is required in order to ascertain the actual results of the franchisee in the operation of the business which will allow the franchisor to determine the amount of the ongoing payments to be made by the franchisee.

This right of the franchisor is to be measured against the right of the franchisee to organise its business as an autonomous entrepreneur. Therefore, inspection as a control activity is to be allowed by the franchisee, provided, however, that it is carried out within the limits imposed by the independent status of franchisees.

C. Inspection

Inspection is a control activity exercised by the franchisor concerning the way in which the franchisee carries out the operation of the business. An inspection is carried out by visiting the franchisee's premises in order to check *in situ* whether the franchisee is conducting the business in conformity with the franchisor's method and quality standards and by having access to the franchisee's accounting books.

D. Reasonable access

Reasonableness in the context of the Article is to be judged by the usual criteria (see definition of "reasonable" in Annex 1). Obviously, an inspection should not take place in the

middle of the night or five times a week. Reasonable access must take place during normal working hours and with a normal frequency and, more generally, only in so far and in such a way as is necessary to guarantee that the business is conducted in accordance with the franchisor's business method. Moreover, the inspection of the accounting books is to be done in so far as it is necessary to assess the business results of the franchisee for a determination of the ongoing payments.

CHAPTER 5: DISTRIBUTORSHIP

Section 1: General

IV.E.–5:101: Scope and definitions

(1) This Chapter applies to contracts (distribution contracts) under which one party, the supplier, agrees to supply the other party, the distributor, with products on a continuing basis and the distributor agrees to purchase them, or to take and pay for them, and to supply them to others in the distributor's name and on the distributor's behalf.

(2) An exclusive distribution contract is a distribution contract under which the supplier agrees to supply products to only one distributor within a certain territory or to a certain group of customers.

(3) A selective distribution contract is a distribution contract under which the supplier agrees to supply products, either directly or indirectly, only to distributors selected on the basis of specified criteria.

(4) An exclusive purchasing contract is a distribution contract under which the distributor agrees to purchase, or to take and pay for, products only from the supplier or from a party designated by the supplier.

COMMENTS

A. General idea

Distribution contracts are contracts concluded between a supplier (who may also be the manufacturer of the products) and a distributor (who may either be a wholesaler or a retailer). The supplier agrees to supply the distributor with products. The distributor commits itself to purchasing, distributing and promoting such products in its own name and on its own behalf.

There are different types of distribution contracts. The type of collaboration between the parties differentiates these contracts from each other. The contract itself addresses what type of exclusivity, if any, is granted. However, exclusivity is not an essential feature of a distribution contract.

Some of the rules in this Chapter apply only to specific types of distribution contracts: exclusive distribution, selective distribution, and exclusive purchase contracts respectively. Different obligations apply depending on the type of exclusivity the parties agree upon. However, these rules may also apply to other distribution contracts (e. g. basic framework agreements) by way of analogy. Furthermore, when the contract provides for bilateral

exclusivity, both regarding purchase and supply, all obligations listed in this chapter will apply.

The typical distribution contract involves the purchase of goods from the supplier for sale by the distributor to customers but there may be cases which involve the leasing of goods or the supplying of services. In these Comments references to “sale” and “purchase” are meant to cover such other means of supply.

B. Interests at stake and policy considerations

The underlying notions in this Chapter are (i) that if parties agree on any exclusivity, they normally have a closer relationship, which requires a higher degree of collaboration and loyalty to each other and (ii) that a party who grants exclusivity to the other party does so in order to obtain some advantage in return.

Consequently, a supplier who refrains from dealing with other distributors by granting exclusive or selective distributorship is for instance entitled to give instructions and to check that they are followed (IV.E.–5:304 (Instructions)). As to the distributor, if the distributor agrees to buy a certain type of product exclusively from one supplier, the distributor receives advertising materials in exchange (IV.E.–5:204 (Advertising materials)).

In a limited number of cases the parties’ freedom of contract is restricted. This is especially the case where exclusivity is granted unilaterally. These exceptional (mandatory) rules are meant to compensate to some extent for imbalance in bargaining power (see IV.E.–5:203 (Warning of decreased supply capacity) paragraph 2, concerning exclusive purchasing contracts).

In contracts where no exclusivity has been agreed upon, the parties do not have strong commitments towards each other. As a result, only basic obligations apply. A non-exclusive or a non-selective agreement could be regarded as nothing more than a loose contract to co-operate and to have some points agreed upon when and if the parties decide to buy or sell the products in question.

Distribution contracts which include exclusivity clauses are rather similar to franchise contracts. For this reason, the obligations of the parties in these two different contracts are dealt with in a consistent manner. This prevents any opportunistic classification of the agreements by the parties aimed at circumventing a less favourable regime.

C. Products

The term “products” in these rules refers to both goods and services (IV.E.–1:101 (Contracts covered)). The same terminology has been adopted by (European) competition law and is consistent with commercial practice. It is largely for this reason that the Article includes the words “take and to pay for” in addition to “purchase”. Some examples of the distribution of services include the distribution of music on the Internet and the distribution of information concerning the financial markets.

D. Continuing basis

A distribution relationship consists of a commercial co-operation between the parties, which may last for a varying, but usually substantial, period of time. This relationship may last even

if for some time no sales or service contracts are concluded. A single sales contract or even a mere accidental succession of sales contracts between the same parties would not amount to a distribution contract.

E. In the distributor's name

This Chapter only applies where the party who distributes products to third parties does so in its own name. In other words, the distributor sells the products which it has bought from the supplier. This is the main difference with commercial agency where the commercial agent does not become owner of the products.

F. On the distributor's behalf

In promoting the sale of the products, the distributor pursues its own interest. This implies that commission agents do not fall within the scope of this Chapter.

G. Framework agreement

A distribution contract is a framework agreement (*contrat cadre*), which provides the context for subsequent contracts (*contrats d'application*). A framework contract usually only defines the basic elements of the subsequent contracts, without establishing the specific modalities.

Whereas the *contrat d'application* is usually of short duration and binds the parties to precise obligations, the framework agreement is meant to establish a relationship of ongoing collaboration between the parties. The “application” contracts will usually result from the orders by the distributor to the supplier.

H. Exclusive distribution contracts

In exclusive distribution contracts, the supplier undertakes to supply the products only to one distributor, to the exclusion of other potential distributors, in a specified territory (territorial exclusivity) or to a certain group of customers (exclusive customer allocation). This provides the distributor with some protection against intra-brand competition (i. e. from products of the same brand brought on to the market by other distributors). The extent of this protection depends on the agreement.

The definition in paragraph (2) includes both sole distributorships and exclusive distributorships. In the case of a sole distributorship the supplier is entitled to sell directly to customers, whereas in the case of exclusive distributorship, the supplier also agrees to refrain from direct sales.

Examples of exclusive distribution agreements first appeared in the motor industry. Subsequently, these contracts have become common in virtually all branches of the wholesale and retail sector (agricultural machinery, electrical appliances, furniture, beauty products and computer equipment).

Examples of exclusive customer allocation include differentiation between the business and consumer market, between the day and night-time market, et cetera.

In return for territorial exclusivity or exclusive customer allocation, the distributor usually agrees to buy only the supplier's products (exclusive purchasing contract (see below, Comment J) or not to represent competing products (contractual non-competition clause).

I. Selective distribution contracts

Selective distribution contracts result in closed sales organisations. The supplier limits the distribution of the products to those distributors with the qualifications which correspond most closely to the supplier's sales policy.

The selection may be based on either qualitative or quantitative criteria. Examples of qualitative criteria are: the employment of technically qualified staff, the possibility to display the products separately from others, the maintenance of a sufficiently representative selection or a sufficiently wide stock of products, et cetera. Quantitative criteria are: the number of distributors in relation to the population of the territory to be served and a minimum turnover in the products et cetera.

A supplier will opt for this form of distribution in order to maintain the prestige of its brand or image (jewellery, cosmetics, et cetera), to ensure the efficient and speedy distribution of perishable products (fish), to provide a high level of pre-sales or after-sales services which is required because of the technological nature of the products to be distributed (personal computers, electronics, cars, high-tech equipment, et cetera).

J. Exclusive purchasing contracts

If the distributor undertakes to purchase the products (belonging to a certain market category) from the supplier only, the contract will be classified as an exclusive purchasing contract. The exclusivity may be either total or limited to a certain percentage of the distributor's requirements. It may also result from an obligation to purchase a quantity of products that in fact corresponds to the distributor's needs (*de facto* exclusivity). Normally, exclusive distribution agreements also include an exclusive purchase clause. In exchange for the distributor's control of the sale of the supplier's products in a given territory, the distributor then agrees not to buy the contract products from any other than the given supplier. These types of contracts are recurrent, for example, in the petrol and the beer distribution industries.

K. Mixed contracts

Some contractual relationships have the characteristics of a distribution agreement as well as another contract. This is the case, for example, where a distributor also sells some products in the supplier's name, thus acting as a commercial agent. Or, the distributor may purchase with a view not only to reselling the goods but also to transforming or incorporating them into a product for resale. In such cases the rules on distribution regulate those aspects of the contractual relationship which fall under the scope and definitions rule as set out in this Article (see II.-1:108 (Mixed contracts)).

L. De facto distribution contracts and de facto exclusivity

The relationship which provides the framework for consecutive application contracts is the most characteristic element of distribution contracts. If such a relationship *de facto* exists without the parties ever having formally agreed to establish it, either in writing or orally, the rules contained in this Chapter may nevertheless apply, together with the general provisions contained in Chapter 1. This follows from the general rules on the formation of contracts. See II.-4:211(Contracts not concluded through offer and acceptance). Comment A to this Article stresses that a contract may be concluded by conduct alone. In such cases it is not easy to discern when the parties reach an agreement which amounts to a binding contract.

The same holds true for distribution contracts presenting *de facto* exclusivities. Rather than formally imposing exclusivity, the supplier may induce the distributor to obtain all or the major part of the distributor's supplies from the supplier. The latter may do so by granting discounts which are conditional upon total or *quasi*-total loyalty to the supplier's products (loyalty discounts). There may eventually be a tacit agreement on exclusivity or a practice of exclusivity established between the parties. In such a case, the rules in this Chapter on exclusive purchase agreements may apply in spite of the written contract that contains no exclusive purchasing clause. See II.-9:101 (Terms of a contract).

M. Competition law

Distribution contracts may be invalid pursuant to the application of EC and national competition law. In this respect, especially relevant is Commission Regulation (EC) No. 2790/1999 of 22 December 1999 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices, and the various exceptions for specific branches of trade (e. g. Commission Regulation (EC) No. 1400/2002 of 31 July 2002 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector). The provisions provided in this Chapter only apply to exclusive distribution, selective distribution and exclusive purchasing contracts to the extent that they are valid in the light of competition law.

Section 2: Obligations of the supplier

IV.E.-5:201: Obligation to supply

The supplier must supply the products ordered by the distributor in so far as it is practicable and provided that the order is reasonable.

COMMENTS

A. General idea

The supplier must consistently meet the supply orders of the distributor. However, parties are free to agree that the supplier is not obliged to meet all the orders placed by the distributor. This follows from the non-mandatory character of this rule. Moreover, the supplier is only bound to supply products in so far as the supplier is in a position to do so, taking into account the supplier's actual possibilities (i. e. productivity capacity, stock capacity, et cetera). There is no obligation to supply in the case of impracticability. Lastly, the supplier is not bound by orders placed by the distributor if they are not reasonable.

B. Interests at stake and policy considerations

In most cases supply of the products ordered by the distributor will be in the interest of both parties. The supplier sells the products to the distributor and the latter is able to bring them to the market and to make a profit by reselling them. However, this may not always be the case. The supplier, for various reasons, may be either unable or unwilling to supply the distributor.

This Article obliges the supplier to meet the orders placed by the distributor, unless there are pressing reasons not to do so. The aim is to prevent a supplier from arbitrarily refusing to supply its distributors, and thus to provide the distributor with legal certainty.

However, this Article does not impose a mandatory obligation to supply upon the supplier. The rationale is to preserve the supplier's freedom of contract, so that the supplier is not forced to enter into undesired sales contracts.

The distributor's interest and the general interest are protected by the rules on unfair contract terms (see Book II, Chapter 9, Section 4) and by competition law.

C. Obligation to supply and actual supply contracts

The obligation to supply stems from the framework agreement. This provision does not regulate the terms of the contracts for the actual supply of the goods. Provisions on sales or services provide the specific modalities of the "application" contracts (e. g. the time of delivery, conformity of the products, remedies, et cetera).

Non-performance of obligations under the *application contracts* may have consequences for the distribution relationship. The latter issue is dealt with by, for example, the rules on termination for non-performance in Book III, Chapter 3, Section 5 as modified by IV.E.–2:304 (Termination for non-performance). The effect is that the distributor may terminate the contractual relationship if the non-performance of obligations under i.e. the contracts which give precise operation to the general obligation under the framework contract, or a series of such contracts, amounts to a fundamental non-performance.

D. In so far as practicable

The distributor is entitled to demand the fulfilment of its orders as long as this is not excessive for the supplier, taking into account the supplier's actual resources. An order will not be regarded as practicable if the supplier encounters insuperable obstacles or fulfilment would cause inconvenience or expenses on the supplier's part to the extent that it would be substantially out of proportion to the distributor's interest for the supplier to fulfil the obligation to supply.

E. Reasonable order

In accordance with the definition of "reasonable" in Annex 1 reasonableness depends upon the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved. Special market conditions can justify orders exceeding the distributor's normal requests (e. g. a larger order for national team football shirts before the World Cup Finals). An order will be unreasonable if it goes beyond the limits of what would be a normal exercise of such a right by a careful and diligent distributor. This occurs, for instance, when the distributor places extra orders at the very last minute, although the distributor had foreseen (or could have foreseen) long before its actual order the forthcoming need for a much larger amount of products and the distributor knew (or should have known) of the limited supply capacity of its supplier. More generally, the distributor should place the order a reasonable time before the distributor foresees a forthcoming extra need.

IV.E.-5:202: Information by supplier during the performance

The obligation under IV.E.-2:202 (Information during the performance) requires the supplier to provide the distributor with information concerning:

- (a) the characteristics of the products;*
- (b) the prices and terms for the supply of the products;*
- (c) any recommended prices and terms for the re-supply of the products to customers;*
- (d) any relevant communication between the supplier and customers; and*
- (e) any advertising campaigns relevant to the operation of the business.*

COMMENTS

A. General idea

This Article states what information the supplier must make available to the distributor during the contract. It follows from IV.E.-2:103 (Information during the performance) that the parties must supply each other with the information which they have at their disposal and which their counterpart needs for the proper performance of their obligations under the contract. The present provision further specifies certain types of information which are included in the supplier's obligation to inform.

The supplier has to provide some basic information which will enable the distributor to distribute the products effectively. The information concerns the characteristics of the products, the prices and terms for the sale of the products and any recommended prices and terms for the resale of the products. In addition, the supplier must inform the distributor about relevant communication with customers and advertising campaigns that it has started.

B. Interests at stake and policy considerations

The aim of this provision is to ensure that the distributor obtains information which is relevant in order to promote the sales of the products efficiently (e. g. knowing their characteristics and so being in a position to inform customers of them) and competitively (e. g. knowing the recommended prices which other distributors may charge). It is also in the interest of the supplier to inform the distributor about general quality requirements for the distribution of the products it supplies, or about new advertising campaigns. The obligation is not unreasonably burdensome for the supplier, since it only has to communicate information which is available to him and in so far as this is needed by the distributor.

Such further information is required because of the high degree of collaboration between the parties in exclusive distribution, selective distribution and exclusive purchase contracts. Moreover, distribution contracts including any exclusivity are rather similar to franchise contracts. Therefore, they should be treated in a similar way, in order to avoid attempts at opportunistic classification by the parties.

C. Information to be provided

The supplier must actively provide the distributor with the information which it possesses and which the distributor needs to achieve the objectives of the contract. Information includes documentation relating to the products (brochures, leaflets, et cetera) or to advertising campaigns. This obligation continues throughout the whole contractual relationship. It also implies that the supplier has to promptly update the distributor as soon as new relevant information (e. g. concerning modifications and improvements to the products offered and sold) becomes available. Depending on the circumstances, the obligation to inform includes

information of specific types. This Article mentions, in a non-exhaustive list, information regarding the following matters.

The characteristics of the products. In principle, a supplier has to inform the distributor about the products and their use. This enables the distributor to pass such information on to its customers, and to take the general quality requirements et cetera into account. The provision of this product information may include the supply of documentation, guidelines, management and operation manuals and recipes.

The prices and terms for the supply of the products to the distributor. A supplier must communicate its prices to the distributor. Prices referred to in the present paragraph are those relating to the contract between the distributor and the supplier.

The supplier must also inform the distributor about the supplier's terms for the sale of goods and services, including e. g. guarantees and delivery times.

Any recommended prices and terms for the re-supply of the products to customers. A supplier must communicate any recommended prices and terms to the distributor. These prices relate to the contract between the distributor and the final customers. This information is relevant because the distributor is then aware of what others may charge, and, depending on this, it will decide its own price policy in order to be competitive in the market.

The supplier must also inform the distributor about any recommendation as to the terms for the re-supply of the products to customers; e. g. regarding after-sales services, limitation clauses or credit.

Any relevant communication between the supplier and customers. The supplier must inform the distributor about any wishes, preferences or complaints communicated to it by customers within the territory or the specific group exclusively allotted to the distributor and, more generally, about any communication between it and those customers relevant to the distributorship.

Any advertising campaigns relevant to the operation of the business. The supplier must inform the distributor of any advertising campaigns, so that the distributor is able to participate in them and to benefit from them. The performance of this obligation may require the supply of relevant documentation together with samples of promotional material.

D. No formalities

There is no formal requirement for the way in which this obligation must be performed. Nevertheless, in practice such information will normally be given in writing. It may be problematic for the supplier to prove that it properly supplied the distributor with all the required information, when such information is presented otherwise than in a written document.

E. Competition law

The obligation to inform under paragraph (1) (c) only applies to recommended prices which do not amount to price maintenance clauses that are invalid according to competition law.

As an independent merchant, the distributor is free to set the prices charged for the products. However, practice demonstrates the recurrent use of resale price maintenance clauses. These are clauses whereby the distributor of a product undertakes vis-à-vis the supplier to maintain a certain price level when distributing the products. In its group exemption concerning vertical restrictions (Regulation 2790/99), the EU Commission has taken a relatively lenient approach concerning maximum vertical price restrictions. Maximum prices and recommended prices that do not amount to a fixed or minimum resale price as a result of pressure or incentives created by any of the parties are now exempted. In contrast, other forms of resale price maintenance, e. g. minimum resale prices and minimum margins, are still a serious infringement that could lead to invalidity and to the imposition of fines. If the agreement does not fall under Article 81(1) (e. g. because it is not capable of affecting trade between Member States), the resale price maintenance clause will be legal under EU law, but will still have to be reviewed under the applicable national law.

IV.E.–5:203: Warning by supplier of decreased supply capacity

(1) The supplier must warn the distributor within a reasonable time when the supplier foresees that the supplier's supply capacity will be significantly less than the distributor had reason to expect.

(2) For the purpose of paragraph (1) the supplier is presumed to foresee what the supplier could reasonably be expected to foresee.

(3) In exclusive purchasing contracts, the parties may not exclude the application of this Article or derogate from or vary its effects.

COMMENTS

A. General idea

The supplier has to warn the distributor within a reasonable time when the supplier foresees major decreases in its supply capacity. The supplier is presumed to foresee such a major decrease when it could reasonably be expected to foresee it (paragraph (2)). In the case of an exclusive purchase agreement, the rule is mandatory (paragraph (3)).

B. Interests at stake and policy considerations

This Article protects the interests of the distributor. The distributor may have become dependant on the product output of a supplier. This especially occurs when the latter offers a unique product (e. g. a patented innovation) or when the product constitutes a necessary item in the distributor's range. The availability of specific models (e. g. brand new ones) and delivery times are elements which are capable of affecting seriously the competitiveness of the distributor.

The present provision requires real collaboration between the parties. The supplier, who is aware of a significant decrease in its supply capacity, must warn the distributor. On the basis of the supplier's warning, the distributor will be able to avoid damage and liability (e. g. in relation to those orders which the distributor has already accepted from customers).

This obligation is not unreasonably burdensome for the supplier. First, the supplier is only required to warn the distributor in the case of a major change in relation to what the

distributor had reason to expect. Secondly, the distributor is neither entitled to know the reasons for the decrease nor is the distributor entitled to a warning in relation to a supply capacity it had no reason to expect. Finally, the obligation only arises in the case of actual foresight although, because of the difficulty of proving this, the supplier is presumed by paragraph (2) to foresee what it could reasonably be expected to foresee.

Only in the case of exclusive purchase agreements is this rule mandatory. In those agreements, the distributor is left with no alternative but to order those products from the supplier. The distributor depends entirely upon the supply capacity of the supplier (e. g. the supplier's products are the only or main products with which the distributor deals). Therefore, an important decrease in the supplier's supply capacity would have very serious consequences.

C. Reasonable time

The supplier must warn the distributor concerning the forthcoming decrease in supply capacity within a reasonable time. When assessing what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved must be taken into account. (See the definition of "reasonable in Annex1). In principle, the supplier must issue the warning as soon as the supplier is aware of the alarming fact. Moreover, the supplier must leave the distributor a certain amount of time to prepare a reaction and to adapt to the customers' demand. The supplier's warning allows the distributor to avoid the acceptance of orders which the distributor will probably not be able to fulfil.

D. Significant decrease

The supplier is under an obligation to warn the distributor only when the supplier foresees that its supply capacity will be significantly lower. No obligation arises in the case of a merely temporary or minor obstacle to supplying. The present obligation applies both when the decrease of the supply capacity is the result of factors within the supplier's control and where the decrease is the consequence of market conditions or other external factors (e. g. a shortage of raw materials or industrial action).

E. Expectations of the distributor

What amounts to the capacity which the distributor had reason to expect depends on the circumstances of the particular case. In the absence of other more decisive factors, the average supplies over the previous years may serve as a yardstick.

F. Character of the rule

In exclusive purchasing contracts, this is a mandatory rule; the parties may not derogate from this obligation. In exclusive and selective distribution agreements, this rule is a default rule; the parties are free to agree otherwise.

IV.E.-5:204: Advertising materials

The supplier must provide the distributor at a reasonable price with all the advertising materials the supplier has which are needed for the proper distribution and promotion of the products.

COMMENTS

A. General idea

This Article requires the supplier to provide the distributor with advertising materials. The supplier has to supply only the materials which it has at its disposal and which the distributor requests. However, the distributor is entitled to ask only for advertising materials which are necessary for the proper distribution and promotion of the products.

B. Interests at stake and policy considerations

Providing the distributor with the advertising materials which the supplier possesses will usually be in the interest of both parties. On the one hand, this will contribute to a uniform image of the supplier's products in the eyes of the public and to a more effective campaign. On the other hand, the distributor will be identified in the eyes of the customers as a dealer in certain branded products. However, there may be cases in which the supplier prefers to refrain from supplying advertising materials to certain distributors. This Article aims at preventing any discriminatory behaviour, granting distributors equal treatment.

This provision clearly promotes the interests of the distributor. The distributor is free to choose whether or not to join a promotional campaign launched by the supplier. However, this Article is not too burdensome for the supplier. The supplier is not required to start a promotional campaign merely to please the distributor. In addition, the supplier is not required to search for advertising materials which the supplier no longer possesses, e. g. linked to old promotional campaigns. Moreover, the Article only refers to what is needed in order to promote the sales of the products.

C. Advertising materials

Advertising materials are additional and accessory materials related to the distribution activity, e. g. fittings for the distributor's premises such as posters, chairs, sunshades, signs and special offers.

D. Reasonable price

The distributor who decides to participate in a campaign must have access to the advertising materials at a reasonable price. To assess what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved must be taken into account. (See the definition of "reasonable" in Annex 1). It would, for instance, be unreasonable to charge the distributor a price which is completely out of proportion to the cost borne by the supplier for the advertising campaign. The same holds true for a price which is far higher than what other distributors have paid or the price in previous similar campaigns.

IV.E.–5:205: The reputation of the products

The supplier must make reasonable efforts not to damage the reputation of the products.

COMMENTS

A. General idea

The supplier is under an obligation not to damage the good reputation of the products which it supplies. This means that the supplier must avoid behaviour which may cause such damage. In certain cases, it must also take the necessary precautions to prevent such damage.

B. Interests at stake and policy considerations

The positive image of the products in the minds of the final customers is one of the elements inducing distributors to promote the sales of such products. This provision requires the supplier not to harm the good reputation that attracted the distributor. Upholding the good reputation of the products should normally be in the interest of both parties. Taking necessary precautions in this respect may be costly.

However, as said, the provisions in this Chapter only apply to exclusive distribution, selective distribution and exclusive purchase agreements. In an exclusive purchasing agreement, the distributor agrees only to buy from one supplier. As a result, the distributor is effectively dependant on the good reputation of the products, somewhat similar to a franchisee. As regards exclusive distribution and selective distribution contracts, the rationale is that the exclusive or selective distributor expects to be in a privileged position with respect to the commercialisation of the products. From this, certain specific default obligations on the part of the supplier will arise. Furthermore, distribution contracts including exclusivities mainly relate to branded products. It is essential for their reputation not to harm the image of the brand.

C. Relation to the PECL

The PECL do not contain such a rule. However, the concept of reasonableness in this Article refers to Article 1:302 PECL. Chapter 3 on Franchising contains a similar rule (Article 3:207).

D. Reasonable efforts

To assess what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved should be taken into account. (See further Article 1:302 PECL).

E. Liability of the supplier

The supplier is only liable for a loss of reputation caused by its acts or omissions; e. g. by the supply of poor-quality products. This means that the supplier is not liable in the case of a breakdown of a brand which is exclusively the result of external factors such as the extraordinary success of a competing good or service.

F. Character of the rule

This is a default rule; the parties are free to agree otherwise.

G. Remedies

The supplier's obligation to make reasonable efforts not to seriously damage the reputation of the products is an obligation in the sense of Article 8:101 PECL. Therefore, in the case of non-performance the aggrieved party may, in principle, resort to any of the remedies set out in Chapter 9 PECL.

Section 3: Obligations of the distributor

IV.E.–5:301: Obligation to distribute

In exclusive distribution contracts and selective distribution contracts the distributor must, so far as practicable, make reasonable efforts to promote the products.

COMMENTS

A. General idea

This Article requires the distributor to enhance the sales of the contract products. The distributor is under an obligation to make reasonable efforts to promote, develop and extend their market.

The obligation is restricted to cases of exclusive and selective distribution contracts.

B. Interests at stake and policy considerations

Both parties have an interest in achieving the highest possible sales volume. The more the distributor sells, the more profit it makes and the more the supplier profits as well. This provision adds that promoting sales is not only a right of the distributor but also an obligation. In exclusive and selective distribution contracts, suppliers take the risk of having only limited channels of distribution. The exclusive and selective distributors are the channels available for suppliers in order to reach the final market. Suppliers agree to refrain from selling to other distributors (in the same area or within the same group of customers) or to unauthorised distributors, respectively.

However, this obligation is not too burdensome for distributors. First, it only requires the distributor to take reasonable steps. Secondly, it applies only so far as practicable. Thirdly, this obligation is in principle restricted to cases of exclusive and selective distribution agreements. By means of a selective distribution system, the distributor makes higher profits than it would have attained otherwise. Exclusive distribution offers the distributor a monopoly position which is, in some aspects, similar to that of the producer. In both cases, distributors are paid back by a certain degree of protection from intra-brand competition.

C. Reasonable efforts so far as practicable

This provision does not impose an obligation of result. The distributor is only under an obligation to make reasonable efforts to resell the supplier's products. In assessing what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved should be taken into account. (See the definition of "reasonable" in Annex 1). The distributor is not obliged to do anything excessive, taking into account the distributor's actual resources.

IV.E.–5:302: Information by distributor during the performance

In exclusive distribution contracts and selective distribution contracts, the obligation under IV.E.–2:202 (Information during the performance) requires the distributor to provide the supplier with information concerning:

- (a) claims brought or threatened by third parties in relation to the supplier's intellectual property rights; and*
- (b) infringements by third parties of the supplier's intellectual property rights.*

COMMENTS

A. General idea

This Article indicates what specific information the exclusive or selective distributor is required to provide to the supplier during the contractual relationship. Whenever the distributor is aware of any infringement of, or possible challenge to, the supplier's intellectual property rights (IPR), it has to inform the supplier.

This obligation applies only to exclusive and selective distribution contracts.

B. Interests at stake and policy considerations

The supplier has a clear interest in being informed of any threat to or any infringement of its intellectual property rights. Often the distributor is in a position to provide the supplier with such information. This obligation is not too burdensome for distributors. First, from IV.E.–2:103 (Information during the performance) it follows that the distributor only has to provide information which the distributor possesses. Secondly, exclusive and selective distribution agreements often include the licensing by the supplier of intellectual property rights to the distributor. Therefore, it will be also in the interest of the distributor to inform the supplier of any IPR infringement.

In principle, the present obligation only applies in cases of exclusive and selective distribution contracts. The rationale is that if a supplier agrees not to sell to distributors other than the exclusive or authorised ones that is because of the supplier's trust in them. It may therefore be expected from a loyal distributor that it should provide the supplier with information which the distributor has that may prevent or limit any harm to the supplier (e. g. information concerning an infringement of any IPR rights).

The information required from the distributor is the same type of information as is required from a franchisee. Since there are similarities between these contracts, it is important to deal with them in a similar way in order to avoid problems of classification.

C. Information to be provided

Exclusive and selective distributors must provide information they possess. This obligation lasts throughout the whole contractual relationship. The Article specifically mentions, in a non-exhaustive list, information regarding the following matters.

- (a) Claims brought or threatened by third parties in relation to the supplier's intellectual property rights

This information relates to claims and threats regarding trademarks, trade names or symbols, or other industrial property rights).

(b) **Infringements by Third parties of the Supplier's Intellectual Property Rights**

Exclusive and selective distributors should inform their suppliers if they are aware that third parties do not respect and infringe the supplier's intellectual property rights.

D. No formalities

There is no formal requirement for the way in which this obligation must be performed, e. g. in writing.

IV.E.-5:303: Warning by distributor of decreased requirements

(1) In exclusive distribution contracts and selective distribution contracts, the distributor must warn the supplier within a reasonable time when the distributor foresees that the distributor's requirements will be significantly less than the supplier had reason to expect.

(2) For the purpose of paragraph (1) the distributor is presumed to foresee what the distributor could reasonably be expected to foresee.

COMMENTS

A. General idea

This Article requires the distributor to warn the supplier whenever it foresees a major decrease in its orders in comparison to what the supplier could reasonably expect. The distributor must notify the supplier within a reasonable time.

The obligation is restricted to cases of exclusive and selective distribution agreements.

B. Interests at stake and policy considerations

This Article protects the interest of the supplier. On the basis of the distributor's warning, the supplier is able to adjust its production, and sometimes even its production capacity, to the new situation. This is especially important in those cases where the supplier sells to large distributors such as large retail chains, e. g. a supermarket chain which has become the only distributor of a leading brand on the national food retail market.

However, this obligation is not unreasonably burdensome for the distributor. First, there is no obligation to warn in the case of minor changes. Secondly, the supplier is not entitled to know the reasons why this change occurs. Thirdly, the obligation only arises in the case of actual foresight, although the difficulty of proving this is alleviated by the presumption in paragraph (2).

In principle, this provision only applies to exclusive and selective distribution agreements. The reason is that under such agreements the supplier is largely dependent, for its entire sales, on the distributors' requirements. If they suddenly do not order any products, the supplier will encounter serious economic difficulties, since it is not in a position to bypass its distributors and sell to other distributors (within a certain area or group of customers) or to unauthorised distributors.

C. Reasonable time

The distributor has to warn the supplier within a reasonable time. To assess what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved must be taken into account (see the definition of “reasonable” in Annex 1). In principle, the distributor must issue the warning as soon as the distributor is aware of the alarming fact. Moreover, the distributor must leave the supplier a certain amount of time to react and to adapt to the new customer demand (e. g. by limiting its production).

D. Significantly less

The distributor need warn the supplier only when it foresees an important decrease in its orders. No obligation arises in the case of only a minor decrease in orders. This obligation exists irrespective of whether the distributor requires less products as a consequence of factors within the distributor’s control or whether this is due to market-related reasons.

E. Expectations of the supplier

What the supplier has reason to expect depends on the circumstances of the case. In most cases, the average quantities ordered over the previous years will be a proper starting point for determining the supplier’s reasonable expectations.

IV.E.–5:304: Instructions

In exclusive distribution contracts and selective distribution contracts, the distributor must follow reasonable instructions from the supplier which are designed to secure the proper distribution of the products or to maintain the reputation or the distinctiveness of the products.

COMMENTS

A. General idea

This Article requires the exclusive or selective distributor to follow reasonable instructions given by the supplier. The distributor must follow only those instructions which aim to secure the proper distribution of the products or to maintain their good reputation.

The obligation is restricted to cases of exclusive and selective distribution agreements.

B. Interests at stake and policy considerations

This provision strikes a balance between two conflicting interests: (i) the distributor’s interest in pursuing its own goals by means of an independent commercial policy and (ii) the supplier’s interest in a professional and uniform presentation and distribution of its products in the market.

This Article protects the interest of the supplier, in that it grants the supplier the possibility to instruct its distributors. The maintenance of the good reputation and distinctiveness of the products may not be attainable unless the distributor follows such instructions. In exclusive and selective distribution contracts, the distributors are the only channels through which the supplier can reach the final market (unless the supplier is entitled to undertake direct sales). In

the case of selective distribution, giving instructions to the authorised distributors is not only a right of the supplier but also an obligation, in order to maintain the same high quality standards within the selective distribution system.

However, the present Article also takes into account the distributor's interest in remaining autonomous. The point here is that the distributor has an interest in the success of its entire range of products. Co-ordinating its behaviour with the commercial policy of the supplier necessarily implies restricting its freedom of manoeuvre (e. g. the distributor gives up some elasticity in the composition of its range of products). Moreover, the present provision does not require the distributor to follow any instruction by the supplier. The distributor has to comply only with those instructions which are relevant in relation to the operation of the distributorship and which are reasonable. Secondly, the present obligation does not apply to any distributor, but only to exclusive and selective distributors, in exchange for their privileged position in the commercialisation of the contract products.

C. Reasonable instructions

The distributor is only required to follow instructions which are reasonable. To assess what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved must be taken into account (see the definition of "reasonable" in Annex 1). Elements to be taken into account to ascertain whether certain instructions are reasonable include: the interests of the parties, the nature of the instruction given as well as their purpose. To be reasonable, instructions should not alter the equilibrium of the contract.

D. To secure proper distribution

The supplier is entitled to instruct distributors with a view to ensuring the proper distribution of the products. Instructions of this kind for instance relate to the setting up and maintenance of specific commercial premises, the packaging of the products and the maintenance of a suitable number of samples of the products for marketing purposes.

E. To maintain reputation and distinctiveness

Especially in the case of the distribution of branded products it is essential that the reputation and the distinctiveness of the products are maintained. Instructions for that purpose relate, for instance, to the arrangement of – or adhesion to – advertising campaigns, the maintenance of certain facilities for the clientele (i. e. assistance services or advice to the clientele) and the presentation and display of the products.

IV.E.–5:305: Inspection

In exclusive distribution contracts and selective distribution contracts, the distributor must provide the supplier with reasonable access to the distributor's premises to enable the supplier to check that the distributor is complying with the standards agreed upon in the contract and with reasonable instructions given.

COMMENTS

A. General idea

This Article requires the distributor to allow the supplier to examine whether the distributor is performing its activity in accordance with the contract and with the instructions which have been given. The supplier's access is limited to the distributor's premises.

The obligation is restricted to cases of exclusive and selective distribution agreements.

B. Interests at stake and policy considerations

The present obligation supplements the main obligation of an exclusive or selective distributor, which is simply to make reasonable efforts in order to promote the sales of the products. Inspection is an important instrument to ascertain whether the distributor has complied with the standards agreed upon in the contract and whether the distributor has followed the relevant instructions. This is fundamental in the case of selective distribution systems. In such cases, the distributor's obligation to provide reasonable access to the premises indirectly benefits other distributors as well. In fact, the poor commercialisation of the products may have negative consequences for other distributors of the same products.

However, the supplier's right to inspect may be very intrusive from the perspective of the distributor. For this reason, this obligation in principle is restricted to exclusive and selective distribution contracts, since in those contracts the supplier grants distributors a privileged position in the commercialisation of its products. Moreover, the present obligation is not too burdensome for the distributor. The distributor is only under an obligation to provide reasonable access to the distributor's premises. The right to inspect does not imply a right for the supplier to have access to accounts. There is no reason which would justify such an intrusion. Unlike in commercial agency, no commission is calculated on the basis of the contracts concluded nor are there, as in franchise agreements, any fees to be paid on the basis of volume.

C. Reasonable access

The supplier is entitled to carry out a reasonable inspection. To assess what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved must be taken into account (see the definition of "reasonable" in Annex 1). In general, the supplier is permitted to check whether the standards agreed upon and the instructions have been met. Moreover, the supplier's inspection should not obstruct or alter the distributor's commercial activities.

D. Distributor's premises

The supplier's inspection will mainly consist of periodical visits to the distributor's commercial premises, which is the location in which the distributor promotes the sales to its customers (e. g. quality control). This Article does not entitle the supplier to have access to the accounts of the distributor; i. e. the supplier is not entitled to request the distributor to render reports on sales, stock and prospective business.

IV.E.–5:306: The reputation of the products

In exclusive distribution contracts and selective distribution contracts, the distributor must make reasonable efforts not to damage the reputation of the products.

COMMENTS

A. General idea

This Article obliges the distributor to avoid any behaviour which could seriously harm the good reputation of the supplier's products. The obligation requires the distributor to take the necessary precautions to avoid such damage.

The obligation is restricted to cases of exclusive and selective distribution agreements.

B. Interests at stake and policy considerations

Maintaining the good reputation of the contract products is normally in the interest of both parties. However, the distributor may lose some interest in dealing with the contract products, if for instance it favours another product that it distributes as well, or if it envisages bringing the contractual relationship to an end. The present provision aims to prevent the distributor from damaging the good reputation of the products. It obliges the distributor to take the necessary precautions to avoid such damage.

In principle the present obligation is restricted to cases of exclusive and selective distribution agreements. First, these types of contracts mainly deal with branded products for which image is of the essence and this image may be very easily damaged; e. g. the reputation of the products could be harmed by inadequate packaging, presentation and display of the products by the distributor. Secondly, the idea of commercialising the products via a few refined sales sites is aimed at reinforcing the image of exclusivity attached to the products. Thirdly, since the supplier grants the distributor the privilege of being the only one or one of the few distributors dealing with certain products, it is fair to expect from the distributor a certain loyal behaviour towards the supplier and the products it trades.

C. Reasonable efforts

In assessing what is reasonable, the nature and purposes of the contract, the circumstances of the case and the usages and practices of the trade or profession involved must be taken into account (see the definition of "reasonable" in Annex 1). For instance, an advertising campaign promoted by the supplier which stresses the quality of the after-sales service could be undermined by the fact that the distributors fail to set up the necessary assistance service.

D. Liability of the distributor

The distributor is only liable for a loss of reputation caused by the distributor's acts or omissions. If the loss of reputation is caused by a third party, or by specific market conditions, the distributor is not liable. This would simply be part of the ordinary commercial risk borne by both parties.

PART G. PERSONAL SECURITY

CHAPTER 1: COMMON RULES

IV.G.–1:101: Definitions

For the purposes of this Part:

(a) a “dependent personal security” is an obligation by a security provider which is assumed in favour of a creditor in order to secure a present or future obligation of the debtor owed to the creditor and performance of which is due only if, and to the extent that, performance of the latter obligation is due;

(b) an “independent personal security” is an obligation by a security provider which is assumed in favour of a creditor for the purposes of security and which is expressly or impliedly declared not to depend upon another person’s obligation owed to the creditor;

(c) the “security provider” is the person who assumes the obligations towards the creditor for the purposes of security;

(d) the “debtor” is the person who owes the secured obligation, if any, to the creditor, and, in provisions relating to purported obligations, includes an apparent debtor;

(e) a “co-debtorship for security purposes” is an obligation owed by two or more debtors in which one of the debtors, the security provider, assumes the obligation primarily for purposes of security towards the creditor;

(f) a “global security” is a dependent personal security which is assumed in order to secure all the debtor’s obligations towards the creditor or the debit balance of a current account or a security of a similar extent; and

(g) “proprietary security” covers security rights in all kinds of property, whether movable or immovable, tangible or intangible.

COMMENTS

A. Personal security

“Personal security” as a general term is not familiar to all European countries. It is to be understood as a broad counterpart to the term “proprietary security”. Personal security comprises all those security rights in which a person (whether a natural person or a legal entity) is liable with all that person’s assets in order to secure an obligation of another person, the principal debtor. By contrast, proprietary security (often but not necessarily provided by the debtor of the secured claim) exposes the security provider only with respect to the specific encumbered assets to a right for preferential satisfaction of the secured creditor. The contrast to personal security is obvious. This indicates why personal security is very attractive for creditors and plays a very important role in practice. However, as always, that attractiveness for creditors has to be paid for. It is paid for by an equivalent degree of risk for the provider of personal security. The proper protection of providers of personal security is therefore an important feature of any acceptable set of rules on this subject.

There are two main types of personal security – the dependent and the independent personal security. The dependent personal security is the older; its roots go back to Roman law (*fideiussio*). Centuries of practical experience have resulted in national rules that are relatively well settled, although they vary to some degree between the member states. By contrast, the independent personal security is a phenomenon of modern times which in some countries has not been recognised until very late in the twentieth century and which has only exceptionally been sanctioned by legislators. Most other modern functional types of personal security, such

as binding comfort letters and stand-by letters of credit are covered by one or other of those two central institutions. The only exception is co-debtorship for security purposes.

The terms “dependent” and “independent” personal security are not derived from any national legal system. They are used because they express the salient features of the two types. Personal security may either be *dependent* upon major aspects of the secured claim or it may be *independent* of any possibly underlying claim.

In general, the present rules do not deal with the formation or validity of contracts or other juridical acts for the provision of personal security. This is left to the general rules in Book II along with any applicable European or national rules. However, one major exception is to be found in Chapter 4 of these rules on personal securities provided by consumers. The assumption of liability as a security provider is an area where the consumer requires special protection.

Dependent personal security is dealt with in Chapter 2. The rules in that Chapter are supplemented by specific provisions on consumer protection in Chapter 4 which are also applicable where consumers assume other types of personal security. The rules on independent security can be found in Chapter 3, which in fact will essentially be relevant for personal security granted by business and professional security providers. The rules in Chapters 2 to 4 are subject to a few general rules set out in Chapter 1.

B. Dependent personal security

Introductory. The term “dependent personal security” does not seem to be used by any national legal system in Europe. Instead, various names are given to designate the basic institution – e.g. suretyship or guarantee or caution or cautionary obligation. Unfortunately none of these various names can be said to be firmly rooted or universally accepted. For these reasons it was decided to coin the new functional and descriptive term – “dependent personal security”.

Nature of security provided. A dependent personal security may take three forms. In the vast majority of cases, the security provider promises to make a payment of money. In some specific cases, the payment of damages is promised. The most important example is the issue of a binding comfort letter.

Illustration 1

A, the majority shareholder of company Z, sends a letter to the major creditors of Z which is in financial straits saying: “I herewith undertake to settle all present and future indebtedness of company Z in order to save it from bankruptcy.” If, contrary to his promise, Z does not abide by his letter, the creditors of Z who have received the above undertaking may sue Z for damages based upon the breach of his undertaking.

A security provider may also promise to make a performance other than the payment of money, such as the delivery of marketable securities or even of other goods.

Nature of secured obligation. The secured obligation may be of any type. In the vast majority of cases, it will be a monetary obligation – repayment of a loan, payment of a purchase price or of rent, payment of damages, etc. These obligations – like all secured

obligations – may already have come into existence upon assumption of the security obligation or they may arise in future, such as a claim for damages for non-performance of obligations under a contract just concluded. The secured obligation may be a conditional one. For example, the provider of a personal or a proprietary security may wish to be ensured that, if pursued on the security, recourse against another person is possible. There is no objection to securing such a conditional obligation of a security provider. Indeed this type of security is frequently used in commercial practice. The secured obligation may be a public law obligation. The case law of the European Court of Justice and of national courts furnishes ample support for admitting this variety. (See e.g. *Bundesverband Güterkraftverkehr und Logistik eV (BGL) v. Bundesrepublik Deutschland* (Case C – 78/01) of 23 September 2003, ECR 2003 I 9543 at nos. 6–11; *Berliner Kindl Brauerei AG v. Siepert* (case no. C-208/98) of 23 March 2000, ECR 2000 I 1741 at p. 1752 s. nos. 36–37; *Préservatrice Foncière TIARD SA v. Staat der Nederlanden* (case no. C-266/01) of 15 May 2003, ECR 2003 I 4867 at p. 4893 no. 36, p. 4895 no. 40 and p. 4896 nos. 41 and 43; *Frahuil SA v. Assitalia SpA* (case no. C-265/02) of 5 Feb. 2004, ECR 2004 I 1543 at p. 1554 no. 21.)

Nature of relationship. As a rule, the security provider, especially if not a professional, will not ask or receive any counter-performance for assuming the obligation. By contrast, professional security providers, such as banks or insurance companies, charge a commission for issuing a dependent personal security. Typically, therefore, such security is granted in the framework of a bilateral contract and creates an obligation at least on the part of the security provider. The debtor of the secured obligation as the factual beneficiary of the security is usually indirectly involved in two ways. In the relationship with the creditor, e.g. under a credit agreement, which gives rise to the obligation to be secured, the debtor is usually obliged to engage the provider of a personal security which must fulfil certain minimum conditions set by the creditor. On the other hand, the debtor must ask a security provider to assume a security towards the creditor meeting the latter's conditions. Thus, in fact a triangular relationship comes into being. However, the contents and objectives of each of the three sides of this triangle differ. Two sides can easily be classified as well-known types of bilateral contract: The credit relationship between creditor and debtor (usually including the security agreement), and the mandate or service contract between debtor and security provider. What remains, is the third side, that between creditor and security provider: this is the contractual dependent personal security.

Dependency. Sub-paragraph (a) enumerates the most important elements to which the dependency between security and secured obligation relates. Mere correspondence of the terms regulating the two obligations, though, does not suffice to constitute dependency. Rather, the terms of the contract or other juridical act creating the security must establish a connection with the secured obligation.

The all-important element of the definition is “depends upon”: the basic type of personal security is characterized by the fact that in almost all respects it depends upon the debtor's obligation to the creditor which is secured by the provider of the personal security towards the creditor. The only major exception is to be found in the debtor's insolvency: any reduction or discharge of the debtor's obligations does not affect the security provider's obligation (cf IV.E.–2:102 (Dependence of security provider's obligation) paragraph (2) sentence 2) since this would run counter to the fundamental purpose and function of security. The principle of dependency is not limited to personal security but dominates also proprietary security, both in movables and in immovables. However, today this principle is no longer the only maxim of

personal and proprietary security; rather it is more and more supplemented by security rights that are independent from any specific secured obligation.

In Chapter 2 on dependent personal security, the principle of dependency informs essential provisions, especially IV.E.–2:102 (Dependence of security provider’s obligation) and IV.E.–2:104 (Debtor’s defences available to the security provider).

In at least three cases, the European Court of Justice has also recognized the principle of dependency as the characteristic element of suretyships. The surety’s obligation does not fall due until maturity of the secured obligation and the surety’s obligation may not surpass that of the debtor. These statements were made in order to ascertain whether certain Directives on consumer protection or the Brussels Convention of 1968 on jurisdiction in civil and commercial matters were or were not applicable to suretyships. (See *Préservatrice Foncière TIARD SA* (above) at p. 4891 s. no. 29; cf. also p. 4893 no. 34. Earlier in more general form in *Bayerische Hypotheken- und Wechselbank AG v. Dietzinger* (case no. C-45/96) of 17 March 1998, ECR 1998 I 1199 at p. 1221 nos. 18 and 20 and in *Berliner Kindl Brauerei AG* (above) at p. 1744 no. 26.)

Reverse dependency. While the dependency of the personal security upon the secured obligation is generally recognized, there may also be reverse dependency. The contract or other juridical act giving rise to a dependent personal security may for some reason be invalid (e.g. due to a legal prohibition or disregard of the protective provisions for consumer dependent securities established in Chapter 4 of these Rules) or avoided (e.g. for mistake). Such invalidity or avoidance may give rise to the issue whether this may have repercussions on the secured obligation. This issue was alluded to in a decision of the European Court of Justice (*Dietzinger* case, above, p. 1221 no. 21). This issue is not dealt with in this Part and will depend on the terms (express or implied) of the contract or other juridical act giving rise to the secured obligation.

Performance of secured obligation must be due. Performance of the secured obligation will not be due if it does not exist. So a dependent personal security depends first of all on the existence of the secured obligation. There cannot be an effective dependent personal security unless the secured obligation exists. The existence of the secured obligation will depend on the validity of the contract or other juridical act from which it arises. This may be affected by various factors.

Some such factors may be the personal qualities of the parties to the juridical act. One of the parties, if it purports to be a legal entity, may not have come into existence. Or a natural person, due to age or sickness, may be legally incapable of juridical acts. Any incapacity of this kind may under the applicable national law have the consequence of invalidating the underlying juridical act and therefore preventing the secured obligation from coming into existence. This rule also protects the security provider: the chances of recovery in a claim for recourse against a debtor who is incapable would be small. There is one exception to this general rule. According to IV.E.–2:103 (Debtor’s defences available to the security provider) paragraph (3) the security provider may not invoke the debtor’s lack of capacity or the non-existence of the debtor legal entity if the relevant facts were known to the security provider at the time when the security became effective. For details, reference is made to the Comments to this provision.

Other factors which may affect the validity of the contract or other juridical act from which the secured obligation arises are the various grounds of invalidity (such as mistake, fraud, coercion or threats, or infringement of fundamental principles or mandatory rules) mentioned in Book II, Chapter 7 (Grounds of Invalidity).

In practice more important than existence are the extent of the debtor's obligation which is to be covered by the security and whether or not performance of it is due. "Extent" refers primarily to the amount of money that is usually involved: capital, interest and cost of recovery. However, in the case of a global security the amount of the secured claim may be open-ended and fluctuating, especially if a current account is secured.

Whether performance of the secured obligation is due also depends on its maturity and any other conditions which determine whether it can, at any particular moment, be enforced by the creditor. This will depend on the terms of the contract or other juridical act (or rule of law) from which the secured obligation arises.

The "dependency" of the personal security upon the secured obligation implies that the latter is not identical with the security obligation. There are two separate obligations, owed by two different persons, the security provider, on the one hand, and the debtor of the secured obligation, on the other hand. Neither is it necessary that these two obligations are identical in extent or content. The security obligation can be lower than the secured obligation and due only if certain extra conditions are fulfilled. By contrast, its amount cannot be higher and it cannot be due on less stringent conditions than the secured obligation.

Transfer of right to performance of secured obligation. One consequence of the principle of dependency is that upon transfer of the right to performance of the secured obligation the attendant security also passes to the transferee. For assignments by contract or other juridical act this is provided for by III.-5:115 (Rights transferred to assignee) paragraph (1) since dependent securities are "accessory rights securing the performance." One may assume that the same rule obtains upon legal transfers, unless the contrary is provided.

C. Independent personal security

Introductory. The independent personal security is a close relative to, but in one decisive respect completely different from, a dependent personal security. The one distinguishing feature is the independence of the security provider's obligation to the creditor in contrast to the dependency of the dependent security on the secured obligation. In all other respects the independent and the dependent personal security share the same features and the Comments made above apply.

The detailed rules on independent personal security are to be found in Chapter 3 of these Rules.

Special feature. The decisive special feature of the independent personal security is its independence from any other agreement, especially an underlying contract between the creditor and the debtor. This independence is laid down and specified in sub-paragraph (b). In particular, the existence and extent of the underlying obligation (such as a seller's obligation to deliver or a customer's obligation to pay the price under a contract of sale or for services) are irrelevant for the security provider's obligation.

On the other hand, the validity of the security provider's undertaking itself is an indispensable condition for the security provider's obligation to honour the security. Thus the security provider must have full capacity and the undertaking must have been created without violation of any legal rules or any defects of consent which might give rise to a right of avoidance under Book II, Chapter 7 (Grounds of Invalidity).

The independent character of an independent personal security must be "expressly or impliedly declared". This rule dovetails with IV.G.-2:101 (Presumption for dependent personal security) which establishes a presumption for any personal security being a *dependent* security, "unless the creditor shows that it was agreed otherwise." For letters of credit and stand-by letters of credit, UCP 500 (1993) art. 3 and 4 explicitly and broadly emphasise the independence of the "credit" from underlying contracts or the objects of those contracts, such as goods, services and other performances. More succinctly in the same sense is the UN Convention on Independent Guarantees of 1995 art. 3. Apart from these specific types of an independent personal security, the latter requires an express or implied declaration. An express declaration can usually be found if the title or body of a personal security document contains the words "independent guarantee". An implied declaration of independence can be presumed if an instrument does not make any reference to a secured obligation, as is usual in any dependent personal security; such silence may be treated as an implied declaration of independence.

The provisions of IV.G.-3:101 paragraph (1) specify and confirm the independent character of a security. A merely general reference to an underlying transaction does not impair the independence of an independent undertaking. Usually, an independent security refers to an underlying contract (*e.g.*, of sale or services) or another security (*e.g.*, a default security to the security provided by the bank opening a letter of credit; or a "counter security" to the security issued by the security provider on the instruction of the issuer of the counter security) in order to specify the event upon the occurrence (or non-occurrence) of which performance of the security may be demanded by the creditor. Any such *general* reference to an underlying obligation does not affect the independent character of a security, since the decisive point is that the security provider's obligation to perform is independent of the obligation of the principal as debtor under the underlying contract with the creditor.

Advantages and risks of independent undertakings. At least for professional security providers, such as banks and insurance companies, the independence of their security undertakings has clear economic advantages: they can easily calculate their risk and this risk is a reliable basis for calculating their charges for assuming this risk. While it seems to be more advantageous to assume a dependent personal security since this allows the security provider to invoke the debtor's exceptions and defences, the administration of these counter-rights is difficult, time consuming and uncertain as to its success.

On the other hand, it is precisely the independence of such undertakings which creates a risk for the persons who have caused the issuance of such undertakings in favour of the creditor. Demanding performance of an abstract security or of another independent security does not require the creditor to prove any default on the part of the debtor. This has invited abusive presentations of independent security instruments. In order to counter such practices, defensive provisions had to be instituted along the lines of IV.G.-3:103 (Independent personal

security on first demand) paragraph (2) and IV.G.–3:104 (Manifestly abusive or fraudulent demand).

D. Security provider

This definition requires hardly any comment. The term “security provider” is neutral. It covers any person who is obliged to the creditor under a personal security, whether the latter is dependent or independent. A special situation may arise if the security provider wishes to secure a potential claim for reimbursement against the debtor. In such a case, the debtor may instruct a fourth party to provide a personal security in favour of the primary security provider. In the case of such a counter security provided by a fourth person to the primary security provider, the roles of the parties change: the primary security provider becomes the creditor of the counter security, who may claim performance of the counter security from the secondary security provider.

E. Debtor

In a dependent personal security, two different persons owe obligations to the creditor: One is the debtor of the secured obligation, the other the debtor of the security obligation. The latter is in these Rules called the “security provider” in order to avoid misunderstanding. By contrast, the obligor of the secured obligation can retain the designation of – principal – debtor.

On the other hand, in an independent personal security, only a security provider and a creditor are legally relevant. Since in these cases a secured obligation is not necessary, neither is a debtor, as defined in sub-paragraph (d) of the Article. The two words “if any” refer to this possible absence of a debtor.

F. Co-debtorship for security purposes

Policy. Co-debtorship for security purposes is, as the name suggests, not a traditional security device but rather a functional one. In order to achieve full protection of those persons who deserve it and to counter creditors’ attempts to evade protective provisions for “genuine” security providers, functional devices with security purposes must be covered by these Rules. In some countries, parties sometimes evade mandatory provisions of the national law on personal security (such as a simple or qualified writing) by agreeing on a co-debtorship for security purposes. If, apart from the principal debtor, another person assumes a corresponding obligation towards the creditor, a trilateral relationship comes into being. However, the position of the additional debtor may differ from that of the principal debtor: while the latter requires a credit for a business or professional activity, the additional debtor may, or may not, have any proper interest in the loan granted by the creditor.

Illustration 2a

A young medical doctor D wishes to acquire for his medical office a very expensive instrument and obtains a credit from his bank. D's wife W is also a medical doctor who also practices in D's medical office. Therefore the bank requires W's co-signature of the credit and security agreement. After D's death in an accident, the bank requests payment of the credit from W who invokes the protective rules for consumer security providers.

Illustration 2b

The facts are as in Illustration 2a, except that W is an artist from a wealthy family.

Must W be treated as a genuine co-debtor or does she deserve to be treated as a mere security provider?

Criteria for distinction. Illustrations 2a and 2b suggest that an important, if not the most important criterion is the economic interest which the two obligors have in the granting of the credit. While D's interest is obvious, that of W obviously varies in the two hypothetical cases. It is nil in Illustration 2b, but is as great as that of D in Illustration 2a. In the latter case, W should be treated as a genuine co-obligor, whereas in the former case W clearly qualifies as a mere security provider. The fact that W even in the second case may indirectly benefit from the credit granted to D since the latter's better financial position indirectly will benefit also W, does not meet the requirements of sub-paragraph (e) of the Article. Decisive is the primary purpose of the assumption of debt (cf. "primarily" for purposes of security). As a co-debtor for security purposes acting primarily for purposes not related to her business or profession, W is in Illustration 2b entitled under IV.G.-1:106 (Co-debtorship for security purposes) to the protection of a consumer according to Chapter 4 of the Rules. In the final analysis, the creditor's contract with the two obligors must be interpreted in light of all the circumstances.

Time of assumption of debt irrelevant. The definition in sub-paragraph (e) does not distinguish whether the second obligation had been assumed at the same time as the other (or, possibly, the main) obligation or subsequently. The time element is here as irrelevant as it is for the provision of true personal (or proprietary) security.

Applicable rules. IV.G.-1:106 (Co-debtorship for security purposes) lays down which rules apply to a co-debtorship for security purposes. Most important is the reference to Chapter 4 of this Part containing rules for the protection of a co-debtor for security purposes who is a consumer.

G. Global security

A type of dependent personal security. Most personal securities are limited in one way or another: they secure either a specific credit with a specific amount; or several credits for which a total limit is specified; or a credit for a specific purpose for which a maximum limit can be calculated, etc. Or the security itself is limited to a specific amount. For independent personal securities, the limitation of the security itself is the only feasible method and is standard practice.

However, dependent personal securities do not always fit this scheme because the credits which they secure may be open-ended. The parties, at the time of contracting the secured credit, may not yet know which kinds of credits are to be secured. The standard example is a personal security for a current account or for all future indebtedness of a debtor, where the number, nature and kinds of claims to be secured is initially not yet known. By contrast, personal security for a specific claim for which at the time of contracting the security the upper limit is not yet known is not a global security since it is much less risky than the kinds of credit for which a global security is granted.

Global security and lack of maximum amount of security distinguished. The existence of a global security does not depend upon the fact that the parties have or have not fixed a maximum amount for the security. A security is not global because no maximum limit has been agreed for the security. A security is global if the kind, source or time of credits to be secured is left open by the parties.

Applicable rules. Special rules on global security are to be found in several provisions spread over Chapter 2. According to IV.G.–2:102 (Dependence of security provider’s obligation) paragraphs (3) and (4) global security is exempted from certain limits which are placed upon open-ended ordinary dependent security rights. IV.G.–2:104 (Coverage of security) paragraph (3) limits the coverage of global security to obligations which were created by contracts between the creditor and the debtor of the global security. The most important protective consequence is incorporated in IV.G.–2:107 (Requirement of notification by creditor) paragraphs (2) and (3) which impose upon the creditor of a global security duties of information in favour of the security provider. Finally, where a consumer assumes a global security additional protective rules apply. If the secured amount had not been fixed by the parties, it must have an agreed maximum amount or such a limitation will have to be determined according to IV.G.–2:102 (Dependence of security provider’s obligation) paragraph (3). See IV.G.–4:106 (Nature of security provider’s liability) sub-paragraph (a).

H. Consumer

Terminology. The term “consumer” is used here in an unusual context. Normally a consumer is understood as a contracting party who is the buyer of assets or the receiver of services from a professional seller or a professional provider of services or both. By contrast, in these Rules it is the weak party rather than the professional who may be providing financial services by providing personal security, in whatever form. However, the definition of “consumer” in Annex 1 is appropriate enough for present purposes even if nothing is consumed. A “consumer” means “any natural person who is acting primarily for purposes which are not related to his or her trade, business or profession.”

Consumers are only natural persons because they are the ones who typically need protection. Legal entities and also groups without legal personality are therefore excluded, even if they do not pursue economic purposes because as groups they are typically more powerful than individuals.

On the other hand, individuals who exercise a trade, business or profession are typically better versed and more experienced than “private” individuals. They can also more easily obtain business or legal advice from trade, business or professional organisations with which most are either associated or to which they can easily have access.

Special protective rules on personal security assumed by consumers are to be found in Chapter 4 of these Rules. Moreover, the rules of Chapter 2 apply to all types of personal security assumed by a consumer.

I. Proprietary security

For the application of this Part, proprietary security is defined very broadly. With respect to security in movables, modern phenomena, such as reservation (retention) of ownership (title) and the security transfer of ownership are covered, but also functional equivalents, such as financial leasing and hire-purchase. For the purposes of the present Part, also proprietary security in immovables is comprised.

Proprietary security as such is not covered by this Part. Nevertheless, for the application of some rules of this Part it is necessary to take into consideration also proprietary security. This applies in particular to the rules for the situation where there are several security providers.

Proprietary security rights provided, not by the debtor of the secured obligation but by a third person, have some similarity with the granting of a personal security and can even be combined with the latter.

Illustration 3

At the request of D, his brother T provides both a suretyship to creditor C and a mortgage encumbering his private home. D and T are not successful in their common business and are both declared bankrupt. While C has only a slim chance of recovering the loan from D or from T on the latter's suretyship, the mortgage on T's private home provides a good security.

The relationship between C and T with respect to the mortgage resembles that of a suretyship. But that resemblance is more apparent than real. As mortgagor of his private home, T is liable towards C only up to the limit of the mortgage, but not with all his assets, as he is as surety. On the other hand, the mortgage gives C a preference in enforcing the claim as against all of D's unsecured or less secured creditors.

The preceding discussion illustrates some fundamental differences between personal and proprietary security. Nevertheless, there are also similarities between proprietary security granted by a third party and personal security. However these similarities become relevant not in the primary relationship between secured creditor and third-party security provider, but in the secondary relationship between third-party security provider and debtor, especially if the third-party proprietary security provider has had to make payment to the creditor. Then the third party security provider will normally be entitled to claim reimbursement from another security provider or the debtor. These issues will primarily be dealt with by a special Section of the Part on proprietary security; the present Part, however, already contains rules on the internal recourse between the security providers and on the secondary recourse against the debtor.

IV.G.-1:102: Scope

(1) This Part applies to any type of voluntarily assumed personal security and, in particular, to:

- (a) dependent personal securities, including those assumed by binding comfort letters;***
- (b) independent personal securities, including those assumed by stand-by letters of credit;***
- and***
- (c) co-debtors for security purposes.***

(2) This Part does not apply to insurance contracts. In the case of a guarantee insurance, this Part applies only if and in so far as the insurer has issued a document containing a personal security in favour of the creditor.

(3) This Part does not affect the rules on the aval and the security endorsement of negotiable instruments, but does apply to security for obligations resulting from such an aval or security endorsement.

COMMENTS

A. Types of personal security covered

Personal security. Paragraph (1) opens with a general formula indicating that this Part covers “any type of voluntarily assumed personal security”. Personal security must be contrasted with proprietary security: in the latter case, the security provider’s liability towards the creditor is limited to the encumbered asset. By contrast, in any type of personal security the security provider is liable towards the creditor with all assets – up to the agreed maximum amount, if any.

Types of personal security. This general formula is supplemented by an enumeration of three major types of personal security in paragraphs (a) to (c). However, this enumeration is open-ended, as the words “in particular” indicate. This is necessary in order to make sure that special instruments that may be evolved in future will be covered if they meet the general criterion laid down in the opening general term.

Dependent personal security). Paragraph (1)(a) starts out by mentioning dependent personal securities – the “suretyship guarantees” of English law. See the Comments to the preceding Article. A modern type of dependent personal security expressly mentioned in sub-paragraph (a) is that created by a binding comfort letter.

“Binding” comfort letters. Comfort letters are a recent phenomenon primarily of commercial practice fulfilling a security function outside the traditional scheme of instruments of personal security. Security providers as well as creditors have differing reasons (such as accounting, taxes, fees etc.) to avoid using one of the traditional means of creating a personal security which would achieve the same purpose. One may distinguish a commercial and a non-commercial type. Comfort letters of the commercial type are used in many countries in the framework of corporate financing. As a result of individual negotiation, they are couched in very different terms. So-called comfort letters of a non-commercial type and of a different design are also issued in some countries by individuals in connection with the (temporary) admission of aliens. In these letters the issuer, a citizen and inhabitant, promises, on a form supplied by the public authority, to reimburse public authorities for any financial assistance from public resources that may have to be rendered to the alien during his or her stay in the country.

A preliminary general issue is whether comfort letters are binding. This is partly a question of interpretation to be solved by the rules laid down in Book II, Chapter 8.

Most binding comfort letters, especially those of a commercial type, differ from the usual forms of personal security. The provider undertakes to make payments to the creditor’s debtor (usually a company which is a subsidiary of the security provider or a company controlled by the security provider) in order to enable it to perform its obligations to the creditor. Practice converts any breach of this promise, especially in the debtor company’s insolvency, to a claim for damages by the creditor against the sender of the binding comfort letter.

By contrast, in the non-commercial type of comfort letter the sender promises reimbursement of the public expenses to the creditor, on the same pattern as in a traditional personal security.

The sender of a binding comfort letter will not usually be willing to make payment for the creditor's claims against the debtor, unless the latter is insolvent. Also, the sender will not be willing to pay more or under less favourable conditions than those of the debtor's obligations. These two criteria imply that the rules of Chapters 1 and those of Chapter 2 on dependent personal security apply to binding comfort letters.

Independent personal security. Paragraph (1)(b) deals with independent personal security, the modern branch of the field. One particular form of independent personal security is that assumed by a stand-by letter of credit.

Stand-by letters of credit. In a "pure" letter of credit a bank promises payment of a sum of money to a creditor if the latter so demands; possibly, the creditor has to present certain documents on which the demand is based. Such letters of credit serve as a primary means of payment for goods sold by the creditor or for another performance, such as work or services.

By contrast, stand-by letters of credit serve a security function. They are issued in order to create a security which may be utilised by the creditor if the conditions fixed for its utilisation are fulfilled. Even a "pure" letter of credit may in reality have been issued for a security purpose; that would bring it under the present Part.

Stand-by letters of credit are subject to Chapters 1 and 3 of this Part.

Co-debtorship for security purposes. Recent protective legislation and court practice in some countries, especially that dealing with consumer security providers, extends to debtors who assume a solidary obligation along with the "principal debtor", provided this assumption of debt is undertaken for security only. Such a collateral debtor deserves indeed the same protection as a security provider. The term "co-debtorship" covers both an initial co-debtorship and a subsequent assumption of a solidary debt after the "principal" debtor had already incurred an obligation. Co-debtorship for purposes of security is governed by IV.G.–1:106.

Nature of the secured obligation. One aspect of the secured obligation is already covered by IV.G.–1:101 (a): the secured obligation may be present or future. The latter rule implies that it may also be conditional; if subject to a suspensive condition, it will arise as soon as the condition materialises. If the secured obligation is subject to a resolutive condition, it is a present obligation.

B. Personal security and insurance

In paragraph (2), the first sentence expressly excludes insurance contracts from the scope of application of the present Rules. In a very broad functional sense third party liability insurance may be regarded as a kind of personal security. However, the general structure of insurance contracts of which those contracts form but a part and the special European rules that are envisaged to govern them exclude even this branch of insurance from the scope of application of this Part.

The same general considerations apply to credit insurance, *i.e.* an insurance taken out by the creditor against loss due to the debtor's insolvency. Although functionally very close to a

personal security, credit insurance is everywhere regarded as a pure insurance contract and therefore subject to the relevant rules of this branch of the law.

Functionally even closer to personal security is guarantee insurance since it is taken out by the debtor, usually on the demand of the creditor and in the creditor's favour. Practice and legislation seem to vary considerably from country to country, and this is reflected in differing doctrinal qualifications. These, however, also are highly controversial within some countries, such as GERMANY and SPAIN. In FRANCE, the BENELUX countries, AUSTRIA and apparently also in ENGLAND, guarantee insurance seems to be regarded as a pure insurance contract, insuring the creditor against the debtor's insolvency. In other countries, especially in GERMANY, ITALY and SPAIN, perhaps also in the SCANDINAVIAN countries, the insurer issues on the basis of the insurance contract a (dependent or independent) personal security to the creditor; thus an insurance contract and a personal security are combined. Paragraph (2) sentence 2 restricts the application of this Part to this personal security, to the exclusion of the underlying insurance contract.

C. Personal security and negotiable instruments

Paragraph (3) makes clear that the rules applicable to the aval of negotiable instruments, especially those governed by the Geneva Uniform Laws on Bills of Exchange (arts. 30–32) and of Cheques (arts. 25–27) of 1930 and 1931, respectively, have precedence over the rules of this Part. The same applies to corresponding national laws which are not governed by the aforementioned Geneva Conventions. This is especially true for the form of the aval and the avalist's liability. The same precedence is enjoyed by the ENGLISH and IRISH rules on the security endorsement (sec. 56 Bills of Exchange Act) which differ to some degree from those of the Geneva Uniform Laws.

However, apart from these special rules and the general provisions on negotiable instruments into which those special rules are embedded, paragraph (3) implies that the aval and the security endorsement are two types of personal security; therefore, subsidiarily the rules of this Part apply, as the last half-sentence spells out.

D. Aspects of public law

In practice, personal security, especially in the form of dependent and independent personal securities, plays an important role in economic law. In this respect, various aspects of public law may become relevant.

First, public law rules may establish an obligation, or offer the possibility, to provide personal security, and they may also require specific features for such security. Such public duties and requirements do not, however, affect the legal nature of the personal security that has to be provided. Therefore, the rules of this Part are applicable.

Secondly, personal security may be demanded or provided in order to secure public obligations, such as taxes or customs duties. An example of great practical importance is the international transport of goods under cover of carnets TIR, as regulated by the so-called TIR Convention of 14 November 1975. In essence it provides that border-crossing road transports of goods are exempted from controls and the payment of customs duties if they are made under cover of a carnet TIR. Such carnets are only issued if an approved "guaranteeing association" has provided a carnet TIR. The guaranteeing association is liable, "jointly and

severally with the persons” who owe payment of the customs duties (art. 8 para. (1)); this liability is subsidiary to that of the debtors (art. 8 para. (7)).

Again, the rules of this Part are fully applicable. The fact that the secured obligation is governed by public law does not exclude the application of this Part. This is even true for a dependent personal security where the security provider may invoke the debtor’s defences, possibly even defences rooted in public law.

Thirdly, the strongest aspect of public law may become visible if the state or another public authority provides a personal security, especially a dependent security. Depending upon the legal and factual circumstances, such a security may be regarded as one of private law and therefore be subject to these Rules. But even if it is regarded as one of public law, these Rules may be relevant. If and in so far as there are no specific rules on personal security of public law, the rules of this Part may be applicable directly or at least by analogy.

IV.G.–1:103: Freedom of contract

The parties may exclude the application of any of the rules in this Part or derogate from or vary their effects, except as otherwise provided in Chapter 4 of this Part.

COMMENTS

A. Freedom of contract

This Article reflects and repeats the essence of II.–1:102 (Party autonomy). Strictly speaking, this repetition is unnecessary but it serves as a reminder and it draws attention to the fact that only in Chapter 4 (Special Rules for Personal Security of Consumers) are there any mandatory rules in this Part.

B. Exclusion of these rules

The first part of the Article (down to the word “Part”) deals with a situation which is not yet practical. It is based upon the assumption that the rules of this Part are binding upon the parties, *e.g.* if enacted by national or European legislation. For such a case, the text makes it clear that the rules are not mandatory and can therefore be excluded altogether by the parties.

C. Derogation from these rules

By contrast to what has been said in the preceding comment, the remainder of the Article may become relevant even outside the situation addressed by the first part.

Illustration

Creditor C and surety S have initially agreed that their mutual relations will in future be governed by the present Rules. However, the parties agree that S may not invoke IV.G.–2:103 paragraphs (4) and (5).

D. Specific exception

One major exception from the general power to derogate from the rules of this Part or to vary their effect is contained in Chapter 4 on protection of consumer providers of personal security. The reasons are obvious.

E. General exceptions

In addition to the preceding specific exception, restrictions on party autonomy result from the general rules in Book II – in particular, those on good faith, non-discrimination and grounds of invalidity.

IV.G.–1:104: Creditor’s acceptance

(1) If the parties intend to create the security by contract, the creditor is regarded as accepting an offer of security as soon as the offer reaches the creditor, unless the offer requires express acceptance, or the creditor without undue delay rejects it or reserves time for consideration.

(2) A personal security can also be assumed by a unilateral promise or undertaking intended to be legally binding without acceptance. The rules of this Part apply with any appropriate adaptations.

COMMENTS

A. Creation of security by contract

This Article proceeds from the assumption that a personal security is usually created by contract although exceptionally a mere promise by the security provider may suffice (paragraph (2)). Deviating from the general rule that a contract is concluded by offer and acceptance, paragraph (1) presumes acceptance “as soon as the offer reaches the creditor”. The term “reaches” is defined in II.–1:106 (Notice).

B. Creditor’s presumed acceptance

An express rule appears to be desirable since the general rules on contracting do not provide sufficient certainty: According to II.–4:204 paragraph (2), silence or inactivity does not in itself amount to acceptance; nor does affirmative conduct by the creditor, unless it is known to the security provider (cf. II.–4:205). Therefore an express rule is desirable and necessary in order to preclude the security provider from later denying being bound by the security since the offer had not been accepted. The main rule of this Article implies that the contract of security is concluded as soon as the security provider’s offer reaches the creditor.

This departure from the general rules on contracting is justified since the contract on personal security usually creates an obligation only for the security provider in favour of the creditor. Therefore many legal systems do not insist upon an express acceptance by the creditor. This widely accepted rule is, however, expressed by the present Article only as a rebuttable presumption. The presumption is rebutted if one of the events specified in the second part of the Article occurs.

C. Exceptions

According to the second part of paragraph (1), the presumption of acceptance established by the first part is rebutted if the offer requires express acceptance or if the creditor without undue delay rejects it or reserves time for consideration. The presumption of acceptance by the creditor can be rebutted only by unambiguous declarations of the creditor.

If an express agreement is required, it will be a question of interpretation whether a statement by the creditor amounts to an acceptance. The same is true for a rejection of the offer. The general rules in Book II apply.

If the creditor without undue delay after receipt of the offer of security reserves time for consideration, the creditor must be enabled to examine carefully a complicated security instrument; depending upon the circumstances, the creditor must be allowed the time to consult an advisor.

D. Express acceptance

The ordinary rules on acceptance apply if the offer of security requires an acceptance or if the creditor has effectively reserved time for consideration. Apart from the preceding two cases, the ordinary rules also apply if the creditor, without being “invited” by the security provider to do so, expressly declares acceptance within a time limit fixed by the offeror or else within a reasonable time limit. See also II.–4:207(Late acceptance) and II.–4:208 (Modified acceptance).

E. Security by virtue of debtor’s contract with security provider

The preceding rules also apply if the debtor contracts with the security provider and the security is expressed as a term of that contract in favour of the creditor (cf. Book II, Chapter 9, Section 3 (Effects of stipulation in favour of third party)).

F. Creation of security by promise

The fact that a security provider’s offer of personal security often is not regarded as calling for an express acceptance invites drawing the consequence that not even any acceptance of the offer is necessary; rather, a mere promise suffices. This corresponds to the general rule established in II.–1:103 (Binding effect), according to which “A valid unilateral promise or undertaking is binding on the person giving it if it is intended to be legally binding without acceptance.” A practical example is a binding comfort letter sent by the sole or majority shareholder of a company to all creditors of the latter which is presumed to create a dependent security (IV.G.–2:101 (Presumption for dependent personal security) paragraph (2)).

G. Commencement of security provider’s obligation

The Article implicitly fixes the time at which the security becomes binding if the creditor does not declare acceptance. The fixing of this point in time is relevant for securities that may fix their duration by indicating a period only (e.g. two years) without indicating a precise date of expiration. Also for the application of IV.G.–1:108 (Several security providers: internal recourse) paragraphs (3) and (6), IV.G.–2:102 paragraphs (3) and (4) and IV.G.–2:103 (Debtor’s defences available to the security provider) paragraph (3) a precise date must be determined.

IV.G.–1:105: Interpretation

Where there is doubt about the meaning of a term regulating a security, and this term is supplied by a security provider acting for remuneration, an interpretation of the term against the security provider is to be preferred.

COMMENTS

A. General rules

General rules on interpretation of contracts and other juridical acts are laid down in Book II, Chapter 8. Among these rules, attention must be drawn to the *contra proferentem* rule in II.–8:103 (Interpretation against party supplying term). Doubts about the meaning of a term not individually negotiated are resolved by construing that term against the party which supplied it. Although this provision applies only to contract terms that have not been negotiated individually, in practice there are very many such cases. Financial institutions as professional providers of credit mostly use standard form contracts. However, also if financial institutions act as creditors, they may demand that the security provider's assumption of security be declared on a form supplied by them.

B. Exception

This Article is intended to supplement II.–8:103 (Interpretation against party supplying term) by extending that rule even to terms individually negotiated. The principle expressed in the present Article is based upon two factors. First, a professional security provider will often draw up the security document as much as possible in favour of the security provider, i.e. to the disadvantage of the creditor. Secondly, if this "natural" advantage is combined with granting the security for remuneration, the very least that may be expected is that the instrument be drafted in unequivocal terms that are clearly understandable for the creditor. If, however, contrary to this justified expectation doubts remain as to the meaning of a term in the security instrument, then an interpretation of such a term against the security provider is justified.

IV.G.–1:106: Co-debtorship for security purposes

A co-debtorship for security purposes is subject to the rules of Chapters 1 and 4 and, subsidiarily, to the rules in Book III, Chapter 4, Section 1 (Plurality of debtors).

COMMENTS

A. General

Delimitation. Co-debtorship for security purposes must be delimited from different, though closely similar agreements in which a third person intending to act merely for security purposes is drawn into a relationship between creditor and debtor. Three basic situations may be distinguished: First, the creditor and the third party agree that the latter should be or become a co-debtor for security purposes. Second, the original debtor and the third party agree in favour of the creditor that the third party should become an additional debtor for security purposes; this is a stipulation in favour of the creditor which entitles the creditor to demand performance from the new debtor as well (cf. Book II, Chapter 9, Section 3 (Stipulation in favour of a third party)). By contrast, if the debtor agrees with a third party that the latter should assume the debtor's obligation so that the latter is discharged, this agreement does not bind the creditor unless the creditor agrees. If the creditor does agree, this is a substitution of a new debtor (cf. Book III, Section 2 (Substitution of a new debtor)) and not a co-debtorship. Only in the first two cases is a co-debtorship for security purposes created.

Legal policy. If, in addition to a principal debtor, another person assumes a corresponding obligation towards the creditor in order to *secure* the principal debtor's obligation, a trilateral situation arises which corresponds to that of a (dependent or independent) personal security. The additional security debtor assumes a function which is similar to that of a security provider. This co-debtorship for security purposes is defined in IV.G.–1:101 (Definitions) paragraph (e). While it is certainly not a species of a traditional personal security, it is increasingly realised that functionally it has features of a personal security. For this reason, IV.G.–1:102 (Scope) paragraph (1)(c) includes co-debtorship for the purpose of security in the ambit of this Part.

The present Part regards co-debtorship for security purposes as a distinct legal institution. For this reason, it is mentioned expressly and separately in enumerating the major types of personal security in IV.G.–1:102 (Scope) paragraph (1)(c). It partakes of the features both of co-debtorship and of a personal security. Consequently, this institution generally is governed by the rules on co-debtorship; this respects the intention of the parties who have chosen this particular type of transaction for the purposes which they intend to pursue. However, if and in so far as the parties use a co-debtorship for the purpose of providing security for the creditor, this justifies the application of certain basic rules on personal security, especially Chapter 1.

If the “securing” co-debtor is a consumer, the special protective rules of Chapter 4 apply. In addition, IV.G.–4:102 (Applicable rules) paragraph (1) refers to Chapter 2 on dependent personal security and in the framework of this reference the rules on dependent personal security become applicable and are mandatory in favour of the security provider (IV.G.–4:102 (Applicable rules) paragraph (2)). The reason for selecting this regime is that the rules on dependent personal security are – generally speaking – the most protective ones for security providers. For details, cf. no. 15 below.

Two types of co-debtorship? Co-debtorship for security purposes may exist from the creation of the main obligation.

Illustration 1

A husband and wife sign contemporaneously a credit agreement as debtors for financing the husband's business; the wife, a housewife, merely signs at the special request of the creditor and in order to assist her husband.

It may also be created later if a co-debtor for security purposes subsequently accedes to an already existing obligation of an “ordinary” full debtor. Also the reverse situation would be covered, although it rarely occurs in practice.

The consequences of this distinction are more linguistic than real. If co-debtorship does not exist from the creation of the obligation to be secured, there is no plurality of debtors and therefore no co-debtorship; it comes into being only at the time when an (additional) debtorship for security purposes is created. The same is true if the sequence of creation is reversed.

B. Criteria for security purpose

There is no generally recognised criterion for qualifying a co-debtorship as being assumed for the purposes of security. The test must be whether one of the co-debtors clearly has the greater direct interest in the credit extended and therefore is finally to be saddled with it.

According to IV.G.–1:101(e) (Definitions) there is no co-debtorship for security purposes unless one of the debtors assumes the obligation “primarily” for purposes of security to the creditor. In the final analysis, this depends upon the interpretation of the credit agreement in light of all the circumstances.

A major indication for a co-debtorship with security purposes rather than a full co-debtorship is whether the co-debtor has a personal interest in the performance of the obligations under the contract in which the main obligation is rooted. The fact that the co-debtor’s obligation is coterminous with that of the other debtor and that the co-debtor has co-signed the same document as the other debtor cannot be decisive since this would eventually place the result into the hands of the creditor. If doubts remain, it is preferable to assume that the third person has merely assumed a co-debtorship for security purposes. The fact that a housewife as such indirectly may benefit from the success of her husband’s business cannot be relevant and does not suffice to saddle her with full liability.

Co-debtorship for security purposes has to be delimited not only from co-debtorship as such, but also from other types of personal security, especially from dependent security. According to IV.G.–2:101 (Presumption for dependent personal security) paragraph (1), any “undertaking to pay, ... to the creditor by way of security” is presumed to create a dependent personal security. Therefore the creditor has to show that it was agreed otherwise (IV.G.–2:101 (Presumption for dependent personal security) paragraph (1) last half-sentence). Consequently, there will only be a co-debtorship for security purposes if the creditor can show that the parties unambiguously agreed upon this specific type of personal security.

C. Co-debtorship and personal security combined

An additional reason for covering co-debtorship is that in some countries the parties sometimes call the person assuming an obligation for security purposes a “co-debtor and security provider”. Since these two obligations involve different consequences, the meaning of the instrument, as intended by the parties, will have to be clarified. One possible construction may be that the security provider was meant to provide a dependent security with solidary liability (cf. IV.G.–2:105 (Solidary liability of security provider)). Another possible construction is that the combined formula is intended to express the security character of the assumption of debt.

D. Applicable rules

For the reasons set out above it is not possible to subject co-debtorship for security purposes to all provisions of this Part because this would disregard the basic differences between co-debtorships for security purposes and dependent as well as independent personal securities and the intentions of the parties who have chosen this particular method of providing security. For this reason, it appears necessary to subject such co-debtorships only to the general rules laid down in Chapter 1 and to the special provisions on consumer personal security laid down in Chapter 4 (which also applies rules from Chapter 2 by reference). For the rest, co-debtorships are governed by the rules on plurality of debtors laid down in Book III, Chapter 4, Section 1.

Applicable rules in Chapter 1. According to IV.G.–1:106, a co-debtorship for security purposes is subject primarily to Chapter 1 of this Part. However, only a few rules of Chapter 1 appear to be directly relevant for a co-debtorship for security purpose.

In applying IV.G.–1:107 to 1:109 (Several security providers) a co-debtor for security purposes can easily be put on the same level as one of several security providers. This is true for the relationship *inter se* (IV.G.–1:107), recourse among several security providers (IV.G.–1:108) as well as recourse against the debtor whose obligation is secured (IV.G.–1:109).

IV.G.–1:110 (Subsidiary application of rules on solidary debtors) does not become relevant for a co-debtor for security purposes since IV.G.–1:106 (Co-debtorship for security purposes) itself already declares Book III, Chapter 4, Section 1 to be applicable.

Rules in Chapter 4. A co-debtorship for security purposes is subject also to Chapter 4 of this Part. Chapter 4 contains the special and mandatory rules for consumers who have provided personal security. The application of these rules to co-debtorships for security purposes assumed by a consumer is explained in the framework of Chapter 4.

Rules in Chapter 2. Chapter 4 applies, for the regime for consumer providers of a co-debtorship for security purposes, primarily the rules of Chapter 2 on dependent personal security (cf. IV.G.–4:102 (Applicable rules) paragraph (1)). These rules are declared to be mandatory in favour of the consumer provider of security (IV.G.–4:102 (Applicable rules) paragraph (2)). In general, these rules are the most protective ones for the security providers. Generally speaking, they are also more protective than the rules on co-debtorship which do not provide for any consumer protection. However, in a few instances, the regime for co-debtors laid down in Book III., Chapter 4, Section 1 is more protective than Chapter 2 of the present Part. Where a comparison of the two regimes leads to this conclusion, exceptionally the rules of Chapter 2 are disregarded in favour of the general regime for solidary debtors in Book III. The detailed comparisons are to be found in the Comments to the relevant rules of Chapter 2.

IV.G.–1:107: Several security providers: solidary liability towards creditor

(1) To the extent that several providers of personal security have secured the same obligation or the same part of an obligation or have assumed their undertakings for the same security purpose, each security provider assumes within the limits of that security provider's undertaking to the creditor solidary liability together with the other security providers. This rule also applies if these security providers in assuming their securities have acted independently.

(2) Paragraph (1) applies with appropriate adaptations if proprietary security has been provided by the debtor or a third person in addition to the personal security.

COMMENTS

A. Context and scope

This Article and the next two Articles form, as the partly identical titles indicate, a complex but coherent set of rules dealing with the special problems which arise if there are several security providers. In this situation, the first issue is the kind of liability that exists between the several security providers towards the creditor. This is dealt with in the present Article. The second issue arises after one of the security providers has made payments to the creditor: can the payer have recourse against the other security providers and for how much? This is

dealt with in IV.G.–1:108 (Several security providers: internal recourse). The third issue is whether and for how much the security providers who have satisfied recourse claims by other security providers can have recourse against the debtor. This is dealt with in IV.G.–1:109 (Several security providers: recourse against debtor). All these provisions apply also to a co-debtorship for security purpose, cf. IV.G.–1:106 (Co-debtorship for security purposes).

B. Several providers of personal security

Basic rule. If several persons assume a personal security in favour of a creditor, their liability may be divided or solidary. If the secured obligation amounts to 40.000 and security providers A and B have divided liability, creditor C has a right to 20.000 from each (III.–4:102 (Solidary, divided and joint obligations) paragraph (2); III.–4:104 (Liability under divided obligations)). By contrast, if they are solidarily liable, C may demand the full amount of 40.000 from either A or B (III.–4:102 (Solidary, divided and joint obligations) paragraph (1)), whoever appears to be more solvent, and can leave the payer to seek recourse from the other (III.–4:106 (Apportionment between solidary debtors); III.–4:107 (Recourse between solidary debtors)).

The present Article opts for solidary liability. This is the default rule for the liability of two or more debtors to perform the same obligation (III.–4:103 (When different types of obligation arise) and in the present situation will correspond to the expectations of the parties. Each provider of personal security must assume the risk of being held fully responsible; and this is also in the interest of the creditor. The principle of solidary liability of several personal security providers seems to be generally recognised. Of course, the parties may agree to deviate from this general rule.

There is less unanimity with respect to the question whether solidary liability exists, even if the several contracts of personal security have been assumed independently from each other, especially at various times. However, distinctions as to time or occasions neither make sense nor are they practicable. In reality, all personal security providers are in the same boat and should share the same risk (paragraph (1) sentence 2).

“Secured the same obligation” or “the same security purpose”. This alternative is based upon the basic distinction in this Part between dependent and independent personal securities. Obviously, the first part of the pair of words refers to dependent securities and the second part to independent securities.

“Within the limits of that security provider’s undertaking”. This formula has both a quantitative and a qualitative meaning.

As far as quantity is concerned, a personal security provider may have secured parts only of the same obligation; in this case, paragraph (1) only applies, if and in so far as the various part securities cover the same portion of the secured obligation. In the latter case, the two part security providers are liable as solidary debtors (paragraph (1) sentence 1) unless otherwise provided.

Illustration 1a

For a credit of 3 million, A assumes a security for 1,5 million and B for 0.5 million. Up to 0.5 million, A and B are liable solidarily.

Illustration 1b

As in Illustration 1 a, but the debtor has paid 2 million on his debt. The creditor may then demand all of the remaining 1 million from A; or he may demand up to 0,5 million from B and the remaining amount from A; or he may divide his claim in any other proportion as between A and B, but only within the maxima which A and B, respectively, have agreed as their upper limit of liability.

Illustration 2

For a credit of 3 million, A assumes a security with a maximum amount of 3 million and B a security for any amount surpassing the first 2 million. A and B are solidary debtors for any amount that exceeds 2 million.

As far as the quality of the undertaking is concerned, the security provider may have assumed vis-à-vis the creditor not a solidary liability with the debtor but a merely subsidiary liability (cf. IV.G.–2:105 (Solidary liability of security provider) and IV.G.–2:106 (Subsidiary liability of security provider); in particular, according to IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (b) a security assumed by a consumer creates only a subsidiary liability. The merely subsidiary liability of one or more security providers does not affect the liability of any additional security providers.

C. Personal and proprietary security providers

Paragraph (2) deals with the relatively novel issue of a plurality of personal and proprietary security providers.

Illustration 3

C's credit to D is secured by a proprietary security right encumbering the shares of D in company Z and also by a personal security provided by D's friend F.

Most writers start from the principle that the two groups of security providers should be treated equally. The creditor (and not the law) should be free to choose, according to the circumstances, which of the several security providers to turn to first.

The minority view would establish primary liability of proprietary and only subsidiary liability of personal security providers. It is based upon the idea that personal security, since it charges all the assets of a person, is more risky and therefore deserves more protection by attaching only a subsidiary liability to it. However, this view is not convincing. In fact, the limits between the impact of the two types of security are fluid, depending upon the circumstances. On the one hand, proprietary security may cover virtually all the security provider's assets while; on the other hand, a personal security for a low amount may in fact burden only a small portion of the security provider's property.

IV.G.–1:108: Several security providers: internal recourse

(1) In the cases covered by the preceding Article recourse between several providers of personal security or between providers of personal security and of proprietary security is governed by III.–4:107 (Recourse between solidary debtors), subject to the following paragraphs.

(2) Subject to paragraph (8), the proportionate share of each security provider for the purposes of that Article is determined according to the rules in paragraphs (3) to (7).

(3) Unless the security providers have otherwise agreed, as between themselves each security provider is liable in the same proportion that the maximum risk assumed by that security provider bore to the total of the maximum risks assumed by all the security providers. The relevant time is that of the creation of the last security.

(4) For personal security, the maximum risk is determined by the agreed maximum amount of the security. In the absence of an agreed maximum amount, the amount of the secured obligation or, if a current account has been secured, the credit limit is decisive. If the secured obligation is not limited, its final balance is decisive.

(5) For proprietary security, the maximum risk is determined by the agreed maximum amount of the security. In the absence of an agreed maximum amount, the value of the assets serving as security is decisive.

(6) If the maximum amount in the case of paragraph (4) first sentence or the maximum amount or the value, respectively, in the case of paragraph (5) is higher than the amount of the secured obligation at the time of creation of the last security, the latter determines the maximum risk.

(7) In the case of an unlimited personal security securing an unlimited credit the maximum risk of other limited personal or proprietary security rights which exceed the final balance of the secured credit is limited to the latter.

(8) The rules in paragraphs (3) to (7) do not apply to proprietary security provided by the debtor and to security providers who, at the time when the creditor was satisfied, were not liable towards the latter.

COMMENTS

A. Recourse between several security providers

General. The preceding Article establishes solidary liability of several personal security providers vis-à-vis the creditor. The general rules on recourse between several solidary debtors are well adapted to being applied between several security providers since all security providers are in the same boat. A creditor's decision to demand performance from one security provider rather than another or all is motivated by the creditor's interests.

Shares proportionate to maximum risk. Neither III.-4:107 (Recourse between solidary debtors) nor other provisions of Book III, Chapter 4 determine the size of the individual shares of solidary debtors. III.-4:106 (Apportionment between solidary debtors) paragraph (1) merely says that solidary debtors are liable in equal shares, unless otherwise provided. This is not suitable for recourse among security providers since they often run risks of very different extent. If for example A had assumed a personal security for 1.000 and B one for 300 for a credit being initially 1.300, but reduced by payments of the debtor to 500, it seems to be unfair to divide the remaining 500 between A and B equally, so that both would be internally liable for 250. Under the present Article therefore each security provider is internally liable in proportion to the maximum risk that security provider had assumed.

Illustration 1

For a credit of 3.000 A had assumed a dependent personal security with a maximum amount of 1.000 and B one with a maximum amount of 2.000. The sum of all

maximum risks being 3.000 (1.000 of A + 2.000 of B), A's portion is $\frac{1}{3}$ and B's $\frac{2}{3}$. If the debtor has paid 1.500, A would be internally liable for 500 ($\frac{1}{3}$ of 1.500) and B for 1.000 ($\frac{2}{3}$ of 1.500).

Agreements on another sharing. However, personal security providers may agree upon another sharing (paragraph (3)). For instance, if shareholders of a company with very different holdings had assumed personal securities for a credit granted to their company, it must be possible for them to agree otherwise. But it may be a question of fact whether they wanted to share liability according to the size of their holdings in the company.

Time relevant for calculation of maximum risk. As several securities are not always created at the same time and as their value can differ, it is necessary to define the moment that is decisive for the evaluation of the maximum risk. According to paragraph (3) sentence 2 the moment of creation of the last security is relevant. This is justified since only at this moment can the maximum total and therefore the proportions be established. The time at which a security is assumed must be determined according to general rules, taking into account IV.G.–1:104 (Creditor's acceptance).

Illustration 2

In January, A had assumed a dependent personal security with a maximum amount of 3.000 for a credit to D of 3.000. In May the creditor and A agree to reduce the maximum amount to 2.000 and in June B assumed a dependent personal security with a maximum amount of 1.000. As the moment of creation of the last security is decisive and in June A is liable up to 2.000 and B up to 1.000, the portions are the same as in Illustration 1.

C. Definition of the maximum risk for personal security

Although most personal securities probably are limited by a maximum amount, it is according to these Rules possible to agree upon a dependent personal security without stipulating a maximum amount (cf. IV.G.–2:104 (Coverage of security)). In these cases the maximum risk is determined by the amount of the secured claim or, in case of a current account, by the credit limit at the time of the creation of the last security (paragraph (4) sentence 2 and paragraph (3) sentence 2) since the amount of the secured credit determines the maximum each personal security provider may be obliged to pay.

Illustration 3

For a current account with a credit limit of 3.000 A had assumed a personal security with a maximum amount of 2.000, whereas B had assumed the debt without limitation for security purpose. Later on the credit limit is extended to 5.000. A and B being solidary debtors only for 3.000, A is to that extent internally liable for $\frac{2}{5}$ and B for $\frac{3}{5}$, the latter being alone additionally liable for the remaining 2.000.

If a credit limit does not exist, the final balance of the secured credit is decisive according to paragraph (4) sentence 3. This rule is justified by the mere fact that there is no other possible moment to determine the maximum risk.

Illustration 4

A and B had assumed dependent personal securities for all existing and future obligations of D towards C, A agreeing a maximum amount of 1.000 whereas B's

security had not been limited. If D in the end owes 9.000, A's portion is $\frac{1}{10}$ and B's $\frac{9}{10}$.

D. Definition of the maximum risk for proprietary security

For those types of proprietary security which can only be created if a maximum amount is agreed (*e.g.* real estate mortgages), the maximum risk can be determined as for personal securities paragraph (5) sentence 1). But in most cases of proprietary security in movables, no agreement of a maximum amount will be necessary. The maximum risk is determined in these cases by the value of the assets serving as security (paragraph (5) sentence 2), the moment of creation of the last security being again decisive. If the value of the assets diminishes later on, the proportion is not affected.

Illustration 5

For a credit of 3000 A had assumed a dependent personal security with a maximum amount of 2000 and B gave a car as security to the creditor, the value of the car being 2000 at the time of contracting. Two years later, the debtor has repaid only 1000 and the creditor has obtained the remaining 2000 from A. The latter is entitled to demand 1000 from B as the portion of each security provider is $\frac{1}{2}$. If the value of the car is only 500, A will only get this sum since B is not personally obliged.

E. Limitation of the maximum risk

Often the security provider assumes a personal security or creates another security whose maximum amount or value is at the time of contracting higher than the secured credit. In these situations it seems to be appropriate not to limit the maximum risk by the maximum amount or the value but by the amount of the credit since this is the amount the security is liable for. This is done by paragraph (6).

Illustration 6

For a credit of 3000 A had assumed a dependent personal security with a maximum amount of 4000 and B one with a maximum amount of 1000. If A had to pay 3000 to the creditor, he may demand payment from B up to 750 (the sum of all securities being $3000 + 1000 = 4000$ and B's portion being therefore $\frac{1}{4}$).

However, if the amount of the secured claim is reduced after creation of the last security below the agreed maximum amount of a security, this is irrelevant, since otherwise any payment by the debtor would be mostly to the advantage of the security with the higher risk.

Illustration 7

For a credit of 3000 A had assumed a dependent personal security with a maximum amount of 1.000 and B one with a maximum amount of 2000. The debtor has paid 1500 to the creditor. A's portion remains $\frac{1}{3}$ (= 500) and B's $\frac{2}{3}$ (=1.000), rather than $\frac{10}{25}$ (= 600) and $\frac{15}{25}$ (= 900).

F. Special limitation

Paragraph (4) last sentence deals with an unlimited credit that is secured by an unlimited personal security; the maximum risk here is determined by the final balance of the credit. This rule can without any problems be applied if only unlimited personal securities are assumed since all security providers are equally liable in this situation.

Illustration 8

A and B had assumed dependent personal securities for all existing and future obligations of D towards C, both securities not being limited by maximum amounts. Independently from what D owes finally, both personal security providers are liable for half since the final balance determines both maximum risks which are therefore identical.

The solution according to paragraph (4) is still adequate if an unlimited credit is secured by unlimited personal securities and limited securities, provided that the final balance of the credit is higher than the limitations of the limited securities (cf. Illustration 4). But matters differ if the final balance is lower:

Illustration 9

A and B had assumed dependent personal securities for all existing and future obligations of D towards C; A agreeing a maximum amount of 1000 whereas B's security had not been limited. If the final balance of the credit is 500, A would according to the rule in paragraph (4) be internally liable for two thirds and B (only) for one third.

This solution seems to be unfair because A who only wanted to assume a limited risk is burdened with a higher portion than B who accepted every risk up to the loss of all his assets. Moreover, as is shown by Illustration 8, the situation of A would be better if A had assumed an unlimited personal security. To prevent this obviously unfair result, paragraph (7) limits the maximum risk of the limited security to the final balance of the credit so that finally all security providers are *inter se* equally liable.

G. Exceptions

Paragraph (8) contains two exceptions to the preceding rules. The first exception refers to proprietary security rights granted by the debtor. Since it is the debtor who eventually has to reimburse all other security providers, it would make no sense if the debtor as a provider of proprietary security was allowed to participate in the internal recourse of the security providers as provided for in this Article. If the creditor enforces a security created by the debtor, the debtor may not take recourse against the security providers. On the other hand, if a third party security provider satisfies the creditor, the former is as a matter of course entitled to enforce a security right granted by the debtor, to which the third party security provider is subrogated according to IV.G.-2:113 (Security provider's rights after performance) paragraph (1) sentence 2 read with paragraph (3).

The second exception contained in paragraph (8) relates to security providers who would not have been under any liability towards the creditor. In certain situations for example, a provider of dependent security can refuse payment to the creditor under IV.G.-2:103 (Debtor's defences available to the security provider), while a provider of independent security is not entitled to do so. This position would be undermined if the provider of independent security could after payment to the creditor hold the provider of dependent security internally liable. The same principle applies to a security provider whose liability towards the creditor is only subsidiary: as long as the security provider may invoke the subsidiary character the liability according to IV.G.-2:106 (Subsidiary liability of security provider), this security provider is also protected against other security providers' claims for internal recourse.

IV.G.–1:109: Several security providers: recourse against debtor

(1) Any security provider who has satisfied a claim for recourse of another security provider is subrogated to this extent to the other security provider's rights against the debtor as acquired under IV.G.–2:113 (Security provider's rights after performance) paragraphs (1) and (3), including proprietary security rights granted by the debtor. IV.G.–2:110 (Reduction of creditor's rights) applies with appropriate adaptations.

(2) Where a security provider has recourse against the debtor by virtue of the rights acquired under IV.G.–2:113 (Security provider's rights after performance) paragraphs (1) and (3) or under the preceding paragraph, including proprietary security rights granted by the debtor, every security provider is entitled to a proportionate share, as defined in IV.G.–1:108 (Several security providers: internal recourse) paragraph (2) and III.–4:107 (Recourse between solidary debtors), of the benefits recovered from the debtor. IV.G.–2:110 (Reduction of creditor's rights) applies with appropriate adaptations.

(3) Unless expressly stated to the contrary, the preceding rules do not apply to proprietary security provided by the debtor.

COMMENTS

A. Rights of security provider after exposure to internal recourse

General. If a security provider had been exposed to internal recourse according to IV.G.–1:108 (Several security providers: internal recourse) paragraphs (1) and (2) the next issue is what rights that security provider has against the debtor. This issue is addressed by paragraph (1) of the present Article. It has to be emphasised that this secondary recourse against the debtor does not feature prominently in the legal systems of the member states. The reasons are obvious. More often than not the security provider's chances of recovery from the debtor are low because of the latter's insolvency – precisely because it is especially in such situations that the creditor will demand payment from the security provider instead of the debtor. The situation is different in the area of, amongst others, personal securities on first demand. Also here, the effect of these Rules is that several providers of security are solidarily liable (cf. IV.G.–1:107 (Several security providers: solidary liability towards the debtor) paragraph (1)). However, the creditor typically demands payment from a security provider under such a security not only if the debtor defaults but because this is an easier way of achieving payment. Since in this situation the security provider is held liable by the creditor even though the debtor is solvent, the security provider's rights of recourse against the debtor become more important. Thus, not only the rights of internal recourse between several security providers but also the rights of secondary recourse against the debtor in the situation of a plurality of security providers need to be dealt with.

Rights against the debtor. Paragraph (1) deals with the question of which rights a security provider has against the debtor if the security provider has been exposed to recourse by another security provider according to paragraphs (1) and (2) of the preceding Article.

Secondary recourse against the debtor. Whenever a security provider performs to the creditor, the former acquires both rights against the debtor according to IV.G.–2:113 (Security provider's rights after performance) paragraph (1) sentence 1 and 2 read with paragraph (3) as well as rights against other security providers according to IV.G.–2:113 (Security provider's rights after performance) paragraph (1) sentence 2 read with paragraph (3) and IV.G.–1:108

(Several security providers: internal recourse) paragraph (1). While in principle the security provider can claim reimbursement in full from the debtor, chances of success will typically be higher for proceeding against the other security providers. These are liable to the security provider, who has satisfied the creditor, however, only within the limits of their respective proportionate shares as defined in IV.G.–1:108 (Several security providers: internal recourse) paragraph (2). Therefore, any security provider who has been held internally liable by the security provider who has paid to the creditor may not in turn take recourse against the other security providers on the basis of IV.G.–1:108 (Several security providers: internal recourse) paragraphs (1) and (2), since a right to internal recourse is available only where a solidary debtor has paid more than the correct proportionate share. The security provider may in this situation only try to be reimbursed by the debtor, either directly (cf. the following paragraphs) or indirectly (on the basis of IV.G.–1:109 (Several security providers: recourse against debtor) paragraph (2)).

Subrogation according to paragraph (1) sentence 1. A security provider (the “second” security provider) who has been held liable by the security provider (the “first” security provider) who had satisfied the creditor steps into the shoes of the first security provider according to the first sentence of paragraph (1); The second security provider is subrogated to the rights against the debtor to which the first security provider had been subrogated on paying the creditor (cf. IV.G.–2:113 (Security provider’s rights after performance) paragraph (1) sentence 2). The second security provider is also subrogated to those rights against the debtor which the first security provider had acquired under IV.G.–2:113 (Security provider’s rights after performance) paragraph (1) sentence 1.

This subrogation does not follow from any other provision, at least not to the extent provided for here: no rights are conferred to the security provider in question by II.–4:107 (Recourse between solidary debtors), since this provision applies only if a solidary debtor has performed more than the proper share.

Extent of the subrogation. The extent to which a security provider who is held liable by the security provider who has satisfied the creditor is subrogated to the latter’s rights against the debtor depends upon the extent to which the latter security provider has taken recourse against the former security provider. Since this right to recourse is limited to the other security provider’s proportionate share as defined in IV.G.–1:108 (Several security providers: internal recourse) paragraph (2), this security provider will normally acquire no more than the proportionate share of the rights against the debtor. The security provider who has satisfied the creditor is then entitled to the remaining part. A security provider held liable for less than the proportionate share as defined in IV.G.–1:108 (Several security providers: internal recourse) paragraph (2) is subrogated only proportionally to the rights acquired by the other security provider according to IV.G.–2:113 (Security provider’s rights after performance) paragraphs (1) and (3).

It is important to stress that paragraph (1) sentence 1 of the present Article may not only give a security provider a personal claim for reimbursement against the debtor but may also confer an entitlement to proprietary security rights (not, however, to proprietary security rights provided by third persons) in so far as such rights have passed to the security provider who has satisfied the creditor (IV.G.–2:113 (Security provider’s rights after performance) paragraphs (1) and (3)). It is self-evident, however, that paragraph (1) sentence 1 of the present Article cannot confer any entitlement to rights against the debtor or proprietary security rights which the security provider who sought recourse has not acquired by reason of

performance under the security, but *e.g.* as a counter-security granted by the debtor. The subrogation is limited to rights acquired by the security provider, who seeks recourse from the other security providers, under IV.G.–2:113 (Security provider’s rights after performance) paragraphs (1) and (3).

Subrogation to proprietary security rights. It is expressly spelt out in IV.G.–1:109 Several security providers: recourse against the debtor) paragraph (1) that there is no subrogation to proprietary security rights provided by third persons. Third party proprietary security aside, however, the reference in IV.G.–1:109 Several security providers: recourse against the debtor) paragraph (1) to proprietary security rights granted by the debtor is to be understood in a wide sense. It is meant to cover not only proprietary security rights that a creditor obtains from the debtor (whether by transfer or by creation of a new proprietary security interest), but also proprietary security rights retained by the creditor on the basis of an agreement with the debtor, such as a retention of ownership. While it is envisaged that the future European Rules on Proprietary Security will cover both types of proprietary security rights (although they might to some extent be subjected to different rules), these provisions are not finally drafted yet. Therefore, it is thought to be preferable at this stage to have a rather broad reference to proprietary security rights irrespective of the method of creation instead of an explicit reference to both distinct types of proprietary security.

Reduction of rights. A security provider who – after having paid the creditor – seeks recourse from the other security providers, may find that the rights to recourse are reduced or extinguished because of the security provider’s conduct. This may occur if such conduct makes it impossible for the other security providers to be subrogated to the first security provider’s rights against the debtor, including any proprietary security rights granted by the debtor, or to be fully reimbursed by the debtor (cf. IV.G.–2:110 (Reduction of creditor’s rights)). After the creditor is satisfied only the security provider who has paid the latter is entitled to the latter’s rights against the debtor. The other security providers, however, will be subrogated to these rights once held internally liable by the security provider who satisfied the creditor, and then these rights against the debtor will be available as a means to secure reimbursement from the debtor for these other security providers. Thus the latter have to be protected against any loss or depreciation in value of these rights due to the fault of the security provider who has satisfied the creditor.

This aim is sought to be achieved by paragraph (1) sentence 2. This provision will apply, *e.g.*, where a security provider releases the debtor or fails to realise proprietary securities in due time, which are subsequently lost or depreciated. A security provider who does not timeously commence proceedings against the debtor who then becomes insolvent might also in appropriate circumstances lose rights of recourse against the other security providers. The basic principle can be seen as an aspect of the duty to act in accordance with good faith and fair dealing. A security provider which culpably fails to consider the interests of the other security provider’s may find that rights of recourse against them are appropriately reduced or even extinguished.

B. Other security providers’ entitlement to benefits recovered from the debtor

General idea. The basic principle underlying the provisions about a plurality of security providers is that all security providers securing the same obligation should share the risk which they assumed in proportion to their individual proportionate shares.

One consequence flowing from this principle is that a security provider who has satisfied the creditor under the security is entitled to take recourse against the other security providers up to the extent of their individual proportionate shares according to IV.G.–1:108 (Several security providers: internal recourse). On the other hand, where a security provider obtains relief by taking recourse against the debtor after having duly paid the creditor or any other security provider, this security provider has to share any benefits obtained with the other security providers. Without such participation, individual security providers could effectively reduce their total liability by taking recourse against the debtor to the disadvantage of other security providers who might not be able to get any reimbursement from the debtor, *e.g.* due to an intervening insolvency of the latter.

Security provider's entitlement to share of benefits recovered. Paragraph (2) achieves this objective by obliging any security provider who has taken recourse against the debtor to share any benefits so obtained with the other security providers in proportion to their individual proportionate shares as defined in IV.G.–1:108 (Several security providers: internal recourse). Again, no security provider is bound to let the other security providers participate in any benefits acquired *e.g.* under proprietary security rights granted by the debtor as a counter-security to this security provider only. The liability under paragraph (2) sentence 1 arises only where a security provider has recourse against the debtor under the rights conferred by IV.G.–2:113 (Security provider's rights after performance) paragraphs (1) and (3) or under IV.G.–1:109 (Several security providers: recourse against debtor) paragraph (1) or equivalent claims arising from the underlying relationship between security provider and debtor (*e.g.* a mandate). This liability arises in the case of a recourse by virtue of rights which in appropriate circumstances would have been available to the other security providers as well, if they had paid the creditor or had been held internally liable by another security provider, respectively. It should be emphasised that the reference to proprietary security rights granted by the debtor is to be understood in the same broad sense as in paragraph (1).

Reduction of rights under paragraph (2) sentence 2. Sentence 2 of paragraph (2) refers to IV.G.–2:110 (Reduction of creditor's rights). The intention is to prevent a security provider from sharing in benefits recovered if that security provider has culpably failed to exercise or pursue available rights against the debtor under IV.G.–2:113 (Security provider's rights after performance) paragraphs (1) and (3) or under IV.G.–1:109 (Several security providers: recourse against debtor) paragraph (1).

The rule in paragraph (2) sentence 2 will typically arise in two different sets of circumstances. In the first situation, a security provider might fail to take advantage of proprietary security rights, which subsequently are depreciated. Such conduct would be detrimental to the other security providers as well since in such situations their right to share in any benefits obtained from the debtor could be diminished or become worthless. It would be contrary to good faith and fair dealing to allow the negligent security provider to deprive the other security providers of their right to share in these benefits and yet still claim a right to share in their benefits. The reference to IV.G.–2:110 (Reduction of creditor's rights) is broad enough, however, to cover also situations, in which a security provider wilfully refrains from exercising any rights against the debtor. A security provider may have personal reasons not to demand reimbursement from the debtor although entitled to do so; however, that security provider should not then be able to share in benefits recovered by other security providers.

C. Exception

Proprietary security rights provided by debtor excepted. Paragraph (3) contains an exception referring to proprietary security rights provided by the debtor. In any case, it is the debtor who is liable in the end for the secured obligation, and obviously there is no point in subrogating the debtor to rights against the debtor.

Counter-exceptions. Some provisions in this Article, however, are expressly declared to apply also to proprietary security rights granted by the debtor (paragraph (1) sentence 1 and paragraph (2) sentence 1). These provisions are dealing with the exercise of or the subrogation to rights against the debtor, which for the purposes of this Article follows identical rules for personal as well as proprietary security rights.

IV.G.–1:110: Subsidiary application of rules on solidary debtors

If and in so far as the provisions of this Part do not apply, the rules on plurality of debtors in III.–4:107 (Recourse between solidary debtors) to III.–4:112 (Opposability of other defences in solidary obligations) are subsidiarily applicable.

COMMENTS

A. General

Contracts of personal security and plurality of debtors. Contracts of personal security frequently involve situations where several persons owe similar or even identical obligations to the same creditor. Such situations, which might be described as a plurality of debtors in a non-technical sense, can exist in relation to several debtors owing the same secured obligation, or several security providers securing the same obligation or even under certain circumstances in relation to a debtor owing the secured obligation and a security provider owing an obligation under the contract of personal security that is at least partly identical with the secured obligation.

Solidary obligations according to Book III, Chapter 4 and effect of the present Article in general. The concept of solidary obligations according to Book III, Chapter 4 is rather wide. Therefore, a number of situations described in the preceding paragraph would fall under the rules on solidary debtors in Section 1 of that Chapter. On the one hand, this result has to be welcomed from the point of view of the law of personal security, since a number of the general provisions on solidary debtors fit the needs of this area of law perfectly well, so that a reference to these general provisions replaces the need to spell them out in detail here. On the other hand, the situations of solidary debtors (co-debtorship) in the context of personal security often are governed by considerations that are different from those relevant for situations of solidary debtors in general. Therefore the reference to these general rules can only be made with caution: the general rules are applicable only subsidiarily, *i.e.* as long as the rules in this Part do not contain specific provisions concerning the relevant issue.

Plurality of debtors of the secured obligation. The reference can be made unconditionally, however, in so far as a plurality of debtors owing the same secured obligation is concerned. The rules on personal security do not contain any specific provisions governing this issue, *i.e.*

the effects of events concerning the obligation of one debtor on the obligation of the other debtor or debtors are governed by Book III, Chapter 4, Section 1 only.

Plurality of security providers and co-debtorship between debtor(s) and security provider(s). More important is the reference to the provisions on solidary obligations contained in Book III, Chapter 4, Section 1 in the following types of situations, which will be considered in greater detail in these Comments. Firstly, in the case of several security providers who are all securing the same obligation towards the creditor it has to be emphasised that the provisions on solidary debtors may apply under this heading to providers of dependent and independent security alike, provided that in respect of each security provider concerned the conditions for liability towards the creditor are fulfilled. Secondly, there might be a co-debtorship between debtor(s) on the one hand and security provider(s) on the other hand. A co-debtorship of this type, however, cannot exist if there is an independent personal security only; even in cases of a dependent personal security, such a co-debtorship between the debtor and the security provider can exist only if the liability of the security provider is solidary or, should the latter's liability be subsidiary, if the special conditions according to IV.G.–2:106 (Subsidiary liability of security provider) paragraphs (2) and (3) are fulfilled.

Co-debtorship for security purposes. A special situation concerns the co-debtorship for security purposes according to IV.G.–1:106 (Co-debtorship for purposes). This provision contains its own reference to Book III, Chapter 4, Section 1.

B. Plurality of security providers

General. The rules in IV.G.–1:107 to IV.G.–1:109 deal specifically with a plurality of security providers. Concerning the topics covered by these specific Articles, Book III, Chapter 4, Section 1 is applicable only if it is specifically referred to. However, in a number of other situations outside IV.G.–1:107 to IV.G.–1:109 these general rules can be applied. It has to be emphasised in this context that the rules of III.–4:107 (Recourse between solidary debtors) to III.–4:112 (Opposability of other defences in solidary obligations) are applicable only if the requirements of III.–4:102 (Solidary, divided and joint obligations) paragraph (1) are fulfilled, *i.e.* if all debtors concerned are bound to perform the obligation in full and if the creditor may require performance from any one of them until full performance has been received. In relation to several security providers, such a co-debtorship arises only under the conditions set out in IV.G.–1:107 (Several security providers: solidary liability towards creditor): the conditions for liability towards the creditor must be fulfilled for every security provider concerned.

III–4:107 (Recourse between solidary debtors). As between several security providers who are solidarily liable, III–4:107 (Recourse between solidary debtors) is applicable by virtue of the express reference contained in IV.G.–1:108 (Several security providers: internal recourse) paragraph (1) with the qualifications set out in paragraphs (2) and (3).

III–4:108 (Performance, set-off and merger in solidary obligations) paragraph (1). It follows already from IV.G.–2:113 (Security provider's rights after performance) paragraph (3) (for providers of independent security, IV.G.–3:108 (Security provider's rights after performance) applies), that a security provider who has performed under the contract of personal security is subrogated to the creditor's rights against the other security providers. Consequently, these other security providers are no longer liable towards the creditor to the extent to which the former security provider has fulfilled the obligations under the security.

Within its scope of application, III–4:108 (Performance, set-off and merger in solidary obligations) paragraph (1) serves as a clarification of that implied consequence.

III–4:108 (Performance, set-off and merger in solidary obligations) paragraph (2). This provision is applicable, *i.e.* the merger of debts between one security provider and the creditor discharges the other security providers only for the share of the security provider concerned (this share to be determined according to IV.G.– 1:108 (Several security providers: internal recourse).

III–4:109 (Release or settlement in solidary obligations). If the creditor releases, or reaches a settlement with, one of several providers of dependent security, the consequences are covered by IV.G.–2:110 (Reduction of creditor’s rights) the liability of the other security providers is not affected, but the creditor is liable in damages towards them; this counter-claim can, obviously, be set off against the other security providers’ liability under the contract of dependent personal security. By contrast, there is no specific rule for the effect on the liability of providers of independent personal security; thus III–4:109 (Release or settlement in solidary obligations) paragraph (1) is applicable. This difference in treatment is due to the fact that independent security should be treated in a more formalistic way than dependent security where a more flexible approach is preferable.

III–4:110 (Effect of judgment in solidary obligations) to III–4:112 (Opposability of other defences in solidary obligations). These provisions are generally applicable in the situation of several security providers who are solidarily liable towards the creditor.

C. Co-debtorship between debtor(s) and security provider(s)

General. The following Comments concern the situation where a co-debtorship exists between the debtor(s) on the one hand and the security provider(s) on the other hand, *i.e.* where debtor(s) and security provider(s) are solidary debtors as defined in III–4:102 (Solidary, divided and joint obligations) paragraph (1). Apart from the situation dealt with by IV.G.–1:106 (Co-debtorship for security purposes), such a situation can arise especially where there is a dependent personal security with solidary liability of the security provider, so that the creditor is free to claim performance from the debtor or the security provider as solidary debtors (IV.G.–2:105 (Solidary liability of security provider). In a dependent personal security with subsidiary liability of the security provider, a co-debtorship exists between the security provider and the debtor only if the special conditions under IV.G.–2:106 (Subsidiary liability of security provider) paragraphs (2) and (3) are fulfilled, *i.e.* if the security provider can no longer invoke the subsidiarity as a defence against the creditor. There can be no co-debtorship between security provider and debtor, if any, in the case of an independent security: the obligation of a provider of an independent personal security is conceptually distinct from any underlying obligation. There are two obligations, not co-debtorship of one obligation.

III–4:107 (Recourse between solidary debtors). The rights against the debtor of a security provider who performs the obligation under the contract of personal security are governed by IV.G.–2:113 (Security provider’s rights after performance), so that there is no need to have recourse to III–4:107 (Recourse between solidary debtors). If, however, the debtor fulfils the secured obligation, it can be derived from III–4:107 (Recourse between solidary debtors) that the debtor has no claim against the security provider: internally the debtor is of course liable

for the whole obligation owed to the creditor so that the internal share of the security provider is nil.

III–4:108 (Performance, set-off and merger in solidary obligations) paragraph (1). This provision is not applicable. If, on the one hand, the security provider performs the security obligation towards the creditor, the debtor is not discharged, but IV.G.–2:113 (Security provider’s rights after performance) operates so as to subrogate the security provider to the creditor’s rights against the debtor. If, on the other hand, the debtor performs towards the creditor, the security provider may rely on this performance as against the creditor according to IV.G.–2:103 (Debtor’s defences available to the security provider) paragraph (1). Thus, in this situation the principle of dependency on the secured obligation achieves the same result as III–4:108 (Performance, set-off and merger in solidary obligations) paragraph (1). The same principles apply if there is a set-off as between the creditor and either security provider or the debtor.

III–4:108 (Performance, set-off and merger in solidary obligations) paragraph (2). This provision is applicable; it has to be kept in mind, however, that internally the debtor is liable for the whole of the secured obligation. One has to distinguish between two situations. If the merger of debts takes place between the debtor and the creditor, the security providers are discharged completely. If, however, the merger of debts concerns one security provider (as solidary debtor) and the creditor, the debtor remains liable towards the creditor for the whole debt.

III–4:109 (Release or settlement in solidary obligations). This provision is only in part applicable. It is not applicable in so far as the consequences of a release by the creditor of the debtor on the liability of the security provider are concerned: in such a situation it follows already from the principle of dependency that such a release provides a defence for the security provider vis-à-vis the creditor. If, by contrast, the security provider is released by the creditor, III–4:109 (Release or settlement in solidary obligations) applies: since the debtor is internally liable for the whole of the secured obligation, the effect of the application of this provision is that the debtor is not discharged towards the creditor.

III–4:110 (Effect of judgment in solidary obligations). This provision is applicable only if this would not run counter to the principle of dependency. Thus, contrary to the rule in III–4:110 (Effect of judgment in solidary obligations) a decision by a court as between the debtor and the creditor may affect the security provider’s obligation in so far as according to IV.G.–2:103 (Debtor’s defences available to the security provider) paragraph (1) the security provider, too, may raise the defence of *res judicata* if it is available to the debtor. If a court decides in proceedings between the debtor and the creditor in favour of the debtor – even if only partly – the creditor is barred on the basis of the defence of *res judicata* from bringing another action for the same claim not only against the debtor, but also against the security provider. In other constellations, however, III–4:110 (Effect of judgment in solidary obligations), is applicable, *e.g.* in so far as a court decides against the debtor or in proceedings between the creditor and the security provider.

III–4:111 (Prescription in solidary obligations). This provision is not applicable in so far as the consequences of a prescription of the creditor’s right to performance against the debtor are concerned: in such a situation it follows again from the principle of dependency that the security provider can rely on a prescription of the secured obligation vis-à-vis the creditor.

III-4:111 (Prescription in solidary obligations) is applicable, however, as far as the effect of prescription of the creditor's claim against the security provider on the obligation of the debtor towards the creditor is concerned: according to III-4:111 (Prescription in solidary obligations) sub-paragraph (a) prescription of the creditor's claim against the security provider does not operate as a defence for the debtor vis-à-vis the creditor.

III-4:112 (Opposability of other defences in solidary obligations) paragraph (1). This provision is not applicable. In so far as the possibility of the security provider to invoke a defence of the debtor is concerned, this situation is specifically dealt with in IV.G.-2:103 (Debtor's defences available to the security provider) paragraph (1). Since the security provider's obligation is merely an additional claim for the creditor, the debtor may not rely on any defence of the security provider.

III-4:112 (Opposability of other defences in solidary obligations) paragraph (2). This provision is not applicable. As between the security provider and the debtor, contribution can only be demanded by the security provider from the debtor after the former has performed the security obligation towards the creditor. Should the security provider have failed to raise vis-à-vis the creditor any personal defence of the debtor towards the creditor that was available to the security provider, the security provider may nevertheless claim full reimbursement according to IV.G.-2:113 (Security provider's rights after performance). The interests of the debtor are protected by the security provider's liability for damages according to IV.G.-2:112 (Security provider's obligations before performance) paragraph (2).

CHAPTER 2: DEPENDENT PERSONAL SECURITY

IV.G.-2:101: Presumption for dependent personal security

(1) Any undertaking to pay, to render any other performance or to pay damages to the creditor by way of security is presumed to give rise to a dependent personal security, unless the creditor shows that it was agreed otherwise.

(2) A binding comfort letter is presumed to give rise to a dependent personal security.

COMMENTS

A. Definition and central role

Historically and still today, dependent personal security constitutes the core institution of personal security. This becomes even more obvious if one recurs to the different national names for the most important type of dependent personal security in all the member states (to mention only *suretyship*, *cautionnement*, *Bürgschaft* etc.). All other modern types of personal security, be they dependent (such as the binding comfort letter) or independent (such as indemnities, independent guarantees or stand-by letters of credit) have been developed by modifying the one or the other element of the dependent personal security.

B. General presumption

Paragraph (1) establishes a presumption that when a personal security is assumed it is a dependent personal security. This presumption is based upon the extremely risky nature and implications of any personal security: the security provider becomes liable with all present

and future assets for the liabilities which another person, the debtor, has incurred or may incur in future. By virtue of the dependency upon the secured obligation, these risks can to some degree be limited. Therefore any personal security in favour of the creditor of another person is presumed to be dependent and therefore to be subject to Chapter 2.

The presumption in favour of a dependent security applies vis-à-vis all other types of personal security including both the independent personal security and the co-debtorship for security purposes. If the parties intend to agree upon an independent personal security or a co-debtorship for security purposes, this must expressly be said or unambiguously result from the agreement of the parties. Otherwise, it will be assumed that the parties intended to agree upon a dependent security, which is in general the most favourable for the security provider.

It goes without saying that the presumption in favour of a dependent security should also apply, and for particularly good reasons because of its protective function, to a personal security assumed by a consumer.

C. Binding comfort letter

Paragraph (2) establishes merely a presumption as to the classification of a personal security assumed by binding comfort letter. The presumption can, of course, be rebutted. The presumption is based upon the typical interests pursued by a “patron” in issuing a binding comfort letter of a commercial type. If the promise to the creditor to support financially the debtor (company) is not kept, the breach of that promise is sanctioned by an obligation to compensate the creditor for the loss suffered. On the other hand, the “patron” generally will not be willing to be liable for those obligations of the debtor which are subject to objections or defences.

The preceding two reasons speak for classifying the obligation assumed by the binding comfort letter, in the context of the present Rules, as a dependent personal security – unless the contrary is proved.

In the case of a non-commercial binding comfort letter where the author promises to reimburse the creditor for any expenses incurred in assisting the debtor in so far as the debtor is liable to repay them and does not do so, this is the typical situation of a dependent personal security.

D. Consumers as security providers – general remarks

The rules on consumer protection for providers of personal security must be based, in order to fulfil their purpose of being protective for the security provider, on the regime of personal security which is most protective for security providers. Generally speaking, this is the regime of dependent personal security in Chapter 2. However, sometimes doubts may arise where exceptionally the application of rules on other security devices is, or may seem to be, more protective for the security provider. Such instances have to be analysed in detail.

The rules on dependent personal security are to be applied not only to a consumer’s dependent personal security, but also to all other types of personal security assumed by a consumer: Specifically, they also apply to a consumer’s independent personal security (cf. IV.G.–4:106 (Nature of security provider’s liability) sub-paragraph (c)) and to a consumer’s co-debtorship for security purposes (cf. IV.G.–4:102(Applicable rules) paragraph (1)).

In applying the rules on dependent personal security to any type of personal security provided by a consumer, it is to be noted that in this context the rules on dependent personal security are mandatory and may not be deviated from to the disadvantage of the consumer security provider (IV.G.–4:102 (Applicable rules) paragraph (2)). This purpose is achieved in two ways which, however, converge in the end. If a consumer assumes a dependent personal security, the rules of Chapter 2 are not only directly applicable, but are made mandatory in favour of the consumer by (IV.G.–4:102 (Applicable rules) paragraph (2)). If a consumer assumes an independent personal security or acts as a co-debtor for security purposes the same result is achieved in two steps: firstly, by declaring applicable to these cases the rules of Chapter 2 (cf. IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (c)) and IV.G.–4:102 (Applicable rules) paragraph (1)) respectively). On this basis IV.G.–4:102 (Applicable rules) paragraph (2) becomes applicable and it provides for the mandatory character of the rules on dependent personal security. Thus, even where the presumption of paragraph (1) is rebutted, every personal security by a consumer security provider will be subject to Chapter 2.

IV.G.–2:102: Dependence of security provider's obligation

(1) Whether and to what extent performance of the obligation of the provider of a dependent personal security is due, depends upon whether and to what extent performance of the debtor's obligation to the creditor is due.

(2) The security provider's obligation does not exceed the secured obligation. This rule does not apply if the debtor's obligations are reduced or discharged:

(a) in an insolvency proceeding;

(b) in any other way caused by the debtor's inability to perform because of insolvency; or

(c) by virtue of law due to events affecting the person of the debtor.

(3) Except in the case of a global security, if an amount has not been fixed for the security and cannot be determined from the agreement of the parties, the security provider's obligation is limited to the amount of the secured obligations at the time the security became effective.

(4) Except in the case of a global security, any agreement between the creditor and the debtor to make performance of the secured obligation due earlier, or to make the obligation more onerous by changing the conditions on which performance is due, or to increase its amount, does not affect the security provider's obligation if the agreement was concluded after the security provider's obligation became effective.

COMMENTS

A. The principle of dependency

This Article is one of the two principal provisions expressing the guiding idea of a dependent personal security, namely the principle of dependency (or accessory, as it is sometimes called). Another important rule which is based upon the principle of dependency is IV.G.–2:103 (Debtor's defences available to the security provider).

B. Main rule

The main rule of the first paragraph expresses this basic feature. The security obligation must not exceed the secured obligation. Whether the secured obligation is due, and the extent of it, will, of course, depend on the terms regulating it. It may, for example, not be currently due because it is conditional and the condition has not yet been purified; or it may be due for performance only after a certain time which has not yet arrived; or it may have prescribed. If any feature of the security obligation exceeds the corresponding element of the secured obligation, the security obligation does not become void. Rather, the respective element of the security obligation is reduced correspondingly.

One application of the principle of dependency occurs upon the transfer of the right to performance of the secured obligation. Due to the practical importance of this phenomenon, this consequence of dependency is usually spelt out explicitly. For voluntary transfers of rights to performance (*i.e.* assignments) III.–5:115 (Rights transferred to assignee) paragraph (1) provides that “all accessory rights, including accessory rights securing the performance” of the assigned right are transferred to the assignee. This is supplemented for security rights which are not accessory by an obligation of the assignor to transfer such rights to the assignee (III.–5:112 (Undertakings by assignor) paragraph (6)). In addition, legal transfers are often provided for non-contractual transfers of claims, especially in the form of subrogation to a creditor’s rights if a person other than the (principal) debtor performs an obligation of the latter. Examples in the present rules can be found in IV.G.–2:113 (Security provider’s rights after performance) paragraphs (1) and (3) and provisions which refer to this rule.

C. Exceptions

Debtor’s insolvency and equivalent events. However, the principle of dependency does not apply in the case of necessity for which the security has been designed, namely where the debtor’s obligations are reduced or it is even discharged in an insolvency proceeding. Generally speaking, an insolvency proceeding over the debtor’s assets does not affect the debtor’s liabilities. Even less does this occur when the opening of such proceedings has been refused, for whatever reason, especially due to insufficient assets of the debtor. Therefore, the relevant personal securities are not affected either.

However, modern insolvency laws tend to provide more and more for opportunities to discharge insolvent debtors, at least certain classes of debtors. Alternatively, the reorganisation of a commercial company and similar arrangements with creditors are provided for in which these may agree to reduce their claims. Nevertheless, the dependent personal securities securing obligations that are reduced or discharged should remain fully effective since they have been agreed upon precisely for the purpose of protecting the secured creditor against the risk of such insolvency.

The same is true if special laws enacted in times of war or general economic crisis liberate fully or partly national debtors or debtors who have fallen in distress. Such laws may for instance provide that debtors must make payments on secured obligations that have fallen due, to a prescribed national institution and that such payments discharge the debtor. Or the secured obligations may simply be declared discharged. Apart from specific legislation, such special rules may also be developed by court practice. Security providers living, or having assets outside these jurisdictions remain liable since they (or their foreign assets) are not subject to such measures which are directed at the persons of a circle of more or less closely defined debtors (*cf.* paragraph (2)(c)). However, even if such laws or practice discharge the

debtor, personal security granted to the debtor is not affected since it would run counter to the very purpose of security which is meant to secure the creditor against risks of this kind.

D. Amount of security

Paragraph (3) gives rules on determining the amount of a security if this has not been expressly fixed by the parties, except if the security provider had assumed a global security. The amount may either be determined from the agreement of the parties, *e.g.* if a security is provided for the purchase price of a specific new car according to the dealer's price list. If the amount cannot be ascertained in this way, then the amount of the security is equal to the amount of the secured obligation at the time at which the security became effective. The security becomes effective upon its creation if at that time the obligation to be secured had already come into existence. By contrast, if the obligation to be secured comes into existence only after creation of the security, the latter becomes effective only at this latter point in time. This will generally correspond to the intention of both parties.

The question which ancillary obligations of the debtor are covered by the amount of the security, is answered separately by IV.G.-2:104 (Coverage of security).

The last term of paragraph (3) indirectly confirms the earlier rule that future claims can be secured, although within the limits indicated by this rule (cf. IV.G.-1:101 (Definitions) sub-paragraph (a)). A suggestion that a maximum amount might be fixed for the protection of security providers has not been followed for commercial security providers since it would unduly restrict business practices. However, if a consumer provides a global security or a specific personal security without a fixed maximum amount, such a security is reduced to a fixed amount which is determined by the amount of the secured obligations at the date on which the security became effective (IV.G.-4:106 (Nature of security provider's liability) sub-paragraph (a)).

Subsequent increases of secured obligation. In the interest of protecting security providers, the extent of their security obligations is, as a rule, fixed at the time at which the security becomes effective; again, this is the presumed intention of both parties. Subsequent increases of the secured obligation, therefore, do not bind the security provider. This applies not only to an outright increase of the amount of the secured obligation; or an aggravation of the payment terms; or to a predating of maturity; but also to the aggravation of other terms of the personal security.

An extension of maturity, by contrast, usually will not increase the security provider's burden provided the security provider keeps within the time limit of the security, if any. If exceptionally there is an increase of burden (*e.g.*, if the debtor has become insolvent), the creditor is liable according to IV.G.-2:110 (Reduction of creditor's rights).

E. Further incidents of dependency

Less frequently arising issues of dependency are not expressly regulated in these rules on personal security. However, solutions can be derived via IV.G.-1:110 (Subsidiary application of rules on solidary debtors) from the general rules on solidary debtors laid down in Book III, Chapter 4, Section 1. Comment C to IV.G.-1:110 applies to the relationship between debtor and solidarily liable security provider.

F. Consumers as security providers

Dependent personal security. Only the application of paragraphs (3) and (4) calls for special explanatory remarks.

Paragraph (3) is supplemented in favour of consumer providers of a dependent security (as well as in relation to other consumer security providers) by IV.G.–4:106 (Nature of security provider’s liability) sub-paragraph (a). Specifically this means that the exception spelt out in the first half-sentence of paragraph (3) concerning global securities without a maximum amount is not applicable.

Generally, agreements between creditor and debtor increasing in any respect the burdens of the secured obligation do not affect the security provider. The exception in favour of a global security in paragraph (4) is qualified for consumers by IV.G.–4:106 (Nature of security provider’s liability) sub-paragraph (a): unless a maximum amount had been agreed for the security, the amount covered by the security has to be determined according to paragraph (3) of the present Article. Amendments can only bind the consumer security provider if they do not exceed the maximum limit of the security.

The rules on a consumer’s dependent personal security are mandatory in favour of the security provider (cf. IV.G.–4:102 (Applicable rules) paragraph (2)).

Other types of personal security. For consumers who have provided security in any form other than dependent security, paragraph (1) and paragraph (2) first sentence of the present Article are also binding. For a consumer who has granted an independent personal security this follows from IV.G.–4:106 (Nature of security provider’s liability) sub-paragraph (c) and for a consumer’s co-debtorship for security purposes this follows from IV.G.–4:102 (Applicable rules) paragraph (1). These two provisions declare applicable the rules of Chapter 2 on dependent personal security, and in the present context these rules are mandatory in favour of the consumer security provider.

For a consumer’s co-debtorship for security purposes, additional protective rules are to be found in III.–4:107 (Recourse between solidary debtors), III.–4:108 (Performance, set-off and merger in solidary obligations); III.–4:109 (Release or settlement in solidary obligations) and III.–4:112 (Opposability of other defences in solidary obligations). These provisions remain applicable in favour of a consumer co-debtor for security purposes.

For independent personal security, the exception to the principle of dependency established by paragraph (2) second sentence merely spells out the general rule: the fate of a possibly underlying claim of the creditor against the debtor in an insolvency proceeding over the latter’s assets is irrelevant for the security provider’s liability towards the creditor.

The effect of a reduction or discharge of one of several co-debtors as a consequence of an insolvency proceeding over the assets of that co-debtor is nowhere explicitly spelt out. However, it would seem that such partial or full discharge is a personal defence in the sense of III.–4:112 (Opposability of other defences in solidary obligations) paragraph (1) sentence 1 and therefore does not benefit any co-debtor. This result would also be in conformity with the security purpose pursued by a co-debtorship for security purposes. The result conforms to

paragraph (2) sentence 2 of the present Article and therefore is in harmony with the results reached for providers of dependent as well as independent security.

Paragraphs (3) and (4) are provisions for the protection of the security provider; as such they are applicable for the protection of consumer providers of an independent security or of a co-debtorship for security purposes as well (cf. IV.G.–4:106 (Nature of security provider’s liability) sub-paragraph (a) and IV.G.–4:102 (Applicable rules) paragraph (1) respectively). However, as in the case of a consumer provider of dependent security, paragraphs (3) and (4) apply to the consumer security providers of an independent security or a co-debtorship for security purposes only subject to the specific consumer protection effects of IV.G.–4:106 (Nature of security provider’s liability) sub-paragraph (a), which is applicable to all types of personal security by consumers.

In the present context, the rules of the Article are mandatory in favour of the consumer, cf. IV.G.–4:102 (Applicable rules) paragraph (2). And in the context of a consumer security provider’s co-debtorship for security purposes the term “debtor” in the present Article means the debtor whose obligation is secured.

IV.G.–2:103: Debtor’s defences available to the security provider

(1) As against the creditor, the security provider may invoke any defence of the debtor with respect to the secured obligation, even if the defence is no longer available to the debtor due to acts or omissions of the debtor occurring after the security became effective.

(2) The security provider is entitled to refuse to perform the security obligation if:

(a) the debtor is entitled to withdraw from the contract with the creditor under Book II, Chapter 5 (Right of Withdrawal).

(b) the debtor has a right to withhold performance under III.–3:401 (Right to withhold performance of reciprocal obligation); or

(c) the debtor is entitled to terminate the debtor’s contractual relationship with the creditor under Book III, Chapter 3, Section 5 (Termination).

(3) The security provider may not invoke the lack of capacity of the debtor, whether a natural person or a legal entity, or the non-existence of the debtor, if a legal entity, if the relevant facts were known to the security provider at the time when the security became effective.

(4) As long as the debtor is entitled to avoid the contract from which the secured obligation arises on a ground other than those mentioned in the preceding paragraph and has not exercised that right, the security provider is entitled to refuse performance.

(5) The preceding paragraph applies with appropriate adaptations if the secured obligation is subject to set-off.

COMMENTS

A. General

This Article supplements the preceding Article by clarifying another aspect of the dependency of the security upon the secured obligation, *i.e.* the debtor’s defences which are available to the security provider.

B. The principle

The main rule is laid down in the first sentence of paragraph (1): “any defence” available to the debtor may be invoked by the security provider. This general rule is in keeping with the principle of dependency laid down in paragraph (1) of the preceding Article.

However, an important qualification to the principle of dependency is established by the last half-sentence of paragraph (1): Any defence that originally had existed but which was lost later due to acts or omissions of the debtor can nevertheless be relied upon by the security provider if the loss occurred after the security became effective. Examples are a loss of a defence due to a waiver by the debtor; or an omission to raise the defence before it becomes time-barred. The rationale of this exception is to protect the security provider’s expectancy to be able to continue to rely on any defence of the debtor which existed at the time the security became effective.

Existence of secured obligation. The secured obligation may not exist. In such a case there is technically no debtor. Nonetheless there may be an appearance of an obligation (for example, a forged document purporting to be signed by the debtor, or a contract which is invalid for some other reason) and the creditor may try to invoke the security. Of course, the security provider can invoke the nullity of the document or the invalidity of the contract just as the apparent debtor could do.

Correspondingly, the secured obligation may have arisen but may thereafter have been duly paid by the debtor or a third person. In this case also, the security provider may counter any possible claim by the creditor by relying on the extinction of the secured obligation just as the debtor could do.

An invalidity of the contract or other juridical act giving rise to the secured obligation may have a variety of causes of a personal nature or related to the subject matter. The debtor may be subject to an incapacity which is unknown to the security provider (so that paragraph (3) does not apply). The underlying contract may have been avoided by the debtor for some such reason as fraud, mistake or threats (cf. Book III, Chapter 7, Section 2) or it may run counter to a legal prohibition and therefore be void or avoided by a court (cf. Book III, Chapter 7, Section 3).

Extent of the secured obligation. Since the obligation of the security provider does not extend beyond the secured obligation, on maturity of the security the security provider will first have to ascertain the exact extent or amount of the secured obligation at the point in time at which it has fallen due. If the dependent security has been given for a current account, it will be necessary to look at the balance of the account at the date of maturity of the security. A common situation where the extent of the secured obligation is likely to be relevant for the purposes of the present Article is where the debtor has paid part of the debt. If the creditor then tries to recover the whole amount from the security provider, the latter can invoke the part payment just as the debtor could do.

Performance of the secured obligation not due. The secured obligation may exist but performance may not be due. It may, for example, be subject to a suspensive condition which has not yet been fulfilled or a suspensive time limit which has not yet arrived. Or the debtor may have a right to refuse performance. An important example is where the period of

prescription of the secured obligation has run. According to III.–7:501 (General effect) paragraph (1), after expiry of the period of prescription “the debtor is entitled to refuse performance”. The security provider may invoke this defence of the debtor, whether or not the debtor had already invoked it. If, however, the security provider had already performed the prescribed obligation, anything conferred by the performance cannot be reclaimed merely because the period of prescription had expired (III.–7:501 (General effect) paragraph (2)).

C. Right to refuse performance

The second paragraph deals with three situations which are not technically defences of the debtor but in which the debtor could nevertheless lawfully refuse performance or bring about such a situation by giving notice. The first (sub-paragraph (2)(a)) is where the debtor has a right to withdraw from the contract with the creditor under the rules on this subject in Book II, Chapter 5. This right will often be of short duration and once the debtor loses it the security provider will also lose the right to refuse performance on that basis. The second situation (sub-paragraph (2)(b)) is where the debtor under the general rules of Book III has a right to withhold performance to the creditor, *e.g.* because the latter is refusing to perform a reciprocal obligation in time. The security provider may in effect invoke the debtor’s right in order to withhold performance of the security obligation to the creditor. Again this right to refuse performance may be temporary. If later the creditor performs, then the security provider is no longer allowed to refuse performance to the creditor. The third situation is where the debtor has a right to terminate the debtor’s contractual relationship with the creditor under the rules in Book III, Chapter 3, Section 5. The typical case would be a right to termination for fundamental non-performance by the creditor of the creditor’s obligations under the contract.

D. Debtor’s lack of capacity

Many countries establish one exception to the principle, which relates to defects or lack of full capacity of the debtor and, in the case of a debtor legal entity, also the lack of legal personality. However, these incapacities or the non-existence of a legal entity must have been known to the security provider at the time when the security became effective. The underlying assumption is that in these cases the security serves the purpose of supplying an important element to overcome the economic consequences resulting from the debtor’s “personal defect”. But the provider of the security must have willingly incurred this risk. Paragraph (3) lays down this rule.

The consequences which any such lack of full capacity or of legal personality has for the security provider’s recourse against the debtor are laid down in IV.G.–2:113 (Security provider’s rights after performance) paragraph (4).

E. Debtor’s unexercised rights of avoidance

The common feature of paragraphs (4) and (5) is that the debtor is entitled to exercise rights of avoidance or set-off but has not done so. Since in general the security provider is not entitled to exercise those rights because of their personal character, but, on the other hand, should not suffer from the debtor’s passivity, some substitute must be designed. The position is not dissimilar to that under paragraph (2).

According to paragraph (4), the security provider is entitled to refuse performance where the debtor has not exercised an available right of avoidance. Examples are a right to avoid the contract which is the basis for a monetary claim by the creditor on the ground of a threat committed by the creditor or a mistake of the debtor. The granting of a right of refusing performance is a compromise: on the one hand, the security provider should not be entitled to

exercise the debtor's right of avoidance since this is based upon a personal decision of the debtor but, on the other hand, should not be disadvantaged by the debtor's non-exercise of a right which by virtue of the principle of dependency is to the security provider's benefit.

F. Unexercised rights of set-off

The reasons just given apply equally if the debtor has a right of set-off against the creditor's claim but has not exercised it.

The same reasons apply also when the creditor also has a right of set-off against the debtor, as usually happens when the debtor has such a right. They also apply if exceptionally only the creditor is entitled to set off, but not the debtor.

G. Effectuation

In order to facilitate the effective realisation of the rights enumerated in the present Article, the security provider has not only a right towards the secured debtor but has even an obligation of inquiry according to IV.G.-2:112 (Security provider's obligations before performance) paragraph (1). Further, the security provider is obliged to raise defences which were communicated by the debtor or which were otherwise known to the security provider (IV.G.-2:112 (Security provider's obligations before performance) paragraph (2)).

H. Consumer as security provider

Dependent personal security. If a consumer has assumed a dependent personal security, the rules of the present Article become mandatory in favour of the security provider by virtue of IV.G.-4:102 (Applicable rules) paragraph (2).

Other types of personal security. *Paragraphs (1) and (2).* From the point of view of a co-debtorship for security purposes, paragraph (1) (subject to the slight qualification in paragraph (2)) allows a security provider to invoke a defence inherent in the debt even in cases where a co-debtor as such had lost this defence due to acts done after the security became effective. This rule goes beyond III.-4:112 (Opposability of other defences in solidary obligations) paragraph (1) sentence 1. Consequently, if applied to a consumer co-debtor for security purposes by virtue of IV.G.-4:102 (Applicable rules) paragraph (1), this rule places the consumer in a better position than a non-consumer security provider.

If a consumer provides an independent personal security, the same result is achieved by virtue of IV.G.-4:106 (Nature of security provider's liability) sub-paragraph (c): the consumer is enabled to invoke defences rooted in an underlying transaction which under the general rules of Chapter 3 the provider of an independent personal security is unable to invoke.

Paragraph (3). Generally, any form of incapacity or even legal inexistence of the debtor, whether a natural person or legal entity, does not affect the obligations of the provider of an independent personal security towards the creditor. The fact that a consumer provider of independent security is by virtue of IV.G.-4:106 (Nature of security provider's liability) sub-paragraph (c) bound by paragraph (3) of the present Article does not therefore weaken the provider's position.

The position of a consumer co-debtor for security purposes is similar. III.-4:112 (Opposability of other defences in solidary obligations) paragraph (1) sentence 1 allows a co-

debtor to invoke any defence which another solidary debtor can invoke, other than a defence personal to that other debtor. The incapacity of the debtor whose obligation is secured is a defence personal to that debtor. (See Comment to III.–4:112). So again the fact that the consumer security provider is subject to paragraph (3) of the present Article does not weaken the provider's position.

Paragraphs (4) and (5). For the consumer security provider of an independent personal security, paragraphs (4) and (5) offer remedies which are not available under Chapter 3. Consequently, there can be no objection to the application of these provisions in favour of a consumer provider of an independent personal security according to IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (c).

The same conclusion applies to a consumer's co-debtorship for security purposes. Paragraph (4) allows a consumer co-debtor for security purposes to invoke a personal defence of the principal debtor to avoid the contract giving rise to the secured obligation. According to III.–4:112 (Opposability of other defences in solidary obligations) paragraph (1) sentence 1, such a remedy is not available to a co-debtor (cf. Comment on that Article). Paragraph (4) (as applied by virtue of IV.G.–4:102 (Applicable rules) paragraph (1)) therefore improves the position of the consumer co-debtor for security purposes. And paragraph (5) goes beyond III.–6:107 (Effect of set-off) since it allows the co-debtor to rely on the principal debtor's defence of set-off, although that defence had not yet been exercised and, as a personal defence could not be exercised by the co-debtor. By making these defences available to a consumer co-debtor for security purposes, the position of the consumer co-debtor is improved. This improvement is due to the reference to Chapter 2 which is contained in IV.G.–4:102 (Applicable rules) paragraph (1).

Mandatory character of consumer protection rules. In all instances in which the provisions of the present Article are applicable, these obtain a mandatory character in favour of the consumer by virtue of IV.G.–4:102 (Applicable rules) paragraph (2).

IV.G.–2:104: Coverage of security

(1) The security covers, within its maximum amount, if any, not only the principal obligation secured, but also the debtor's ancillary obligations towards the creditor, especially:

(a) contractual and default interest;

(b) damages, a penalty or an agreed payment for non-performance by the debtor; and

(c) the reasonable costs of extra-judicial recovery of those items.

(2) The costs of legal proceedings and enforcement proceedings against the debtor are covered, provided the security provider had been informed about the creditor's intention to undertake such proceedings in sufficient time to enable the security provider to avert those costs.

(3) A global security covers only obligations which originated in contracts between the debtor and the creditor.

COMMENTS

A. Survey

Paragraphs (1) and (2) set out those elements of a secured obligation which are, within the financial limits of the dependent security, covered by the latter. By contrast, paragraph (3) excludes for a global security coverage of certain “extraneous” items. Of course, the parties may deviate from any of these restrictions.

B. Principal, ancillaries and sums due upon default

According to paragraph (1) the dependent security primarily covers, apart from the principal, also contractual interest as an ancillary obligation. In addition, the normal items that will arise if a debtor defaults will also be covered since a dependent security is designed to cover such consequential damage, unless otherwise agreed. The typical items are:

- default interest;
- damages or an agreed sum of money or a penalty (where allowed) which fall due on the debtor’s non-performance ; and
- reasonable extra-judicial costs of recovery of the preceding items.

The references to contractual and default interest are not qualified. Indeed, these items will be determined by fixed rates. These rates may be agreed upon by the parties or, if no agreement had been reached, by law. For default interest, III.-3:708 (Delay in payment of money) paragraph (1) provides a specific rule: the rate of default interest is determined by the average commercial bank short-term lending rate to prime borrowers prevailing for the contractual currency of payment at the place where payment is due. Additional damages may be recovered (paragraph (2) of same Article).

The same is true for any compensation which the debtor may owe to the creditor upon any non-performance of a contractual obligation. Such compensation may take the form of damages or payment of an agreed sum of money or, where allowed, a penalty.

By contrast, extra-judicial costs for recovery of the aforementioned items may only be demanded if they are “reasonable”. Where fixed scales for such costs exist, these must be observed. In the absence of such scales, average costs for average efforts must be considered to be reasonable. In both cases, the fixed scales and the reasonableness of average costs must be determined according to the rules and customs prevailing at the place where the services are to be rendered.

C. Costs and expenses of legal proceedings and executions

According to paragraph (2), the costs of legal proceedings and of judicial executions are covered. However, in this case it is necessary for the creditor to inform the security provider in due time, so that the latter is enabled to avert these costs by performing the security obligation.

D. Maximum limit

It goes without saying that all these specified ancillary items are secured only within the maximum limit of a security. If this limit is surpassed and the security provider makes full

payment to the debtor, the following issue arises: to which parts of the secured obligation should this performance be attributed since the various elements of the secured debt may be subject to differing rules, especially with respect to prescription. III.–2:110 (Imputation of performance) paragraph (5) provides that a payment is to be appropriated, first to expenses, secondly, to interest, and thirdly, to the principal; however, the creditor may make a different imputation. Of course, the parties can agree otherwise, *e.g.* by extending the security to cover fully (or partly) all or some of the listed ancillary items.

E. Exclusions and extensions

Items not mentioned in paragraphs (1) and (2) and in the preceding comments are not covered by law. One example is a claim for repayment of a loan on the basis of unjustified enrichment by the creditor if, for whatever reason, the secured obligation is void or avoided. Of course, the parties may agree otherwise. An agreement providing not only for the repayment of a loan according to the terms of the valid loan contract, but also that claims for repayment of any advances made if the loan contract is void would be secured would not constitute a deviation detrimental to the security provider within the meaning of IV.G.–4:102 (Applicable rules) paragraph (2), since this would rather constitute a definition of the subject matter of the contract of security. Generally, any type of principal obligation can be made the object of dependent security; this would include also restitutionary and other non-contractual obligations. Of course, it has to be ascertained in these situations whether the contractual security might also be affected by the factors resulting in the ineffectiveness of the loan contract.

F. Exclusion of non-personal and non-contractual secured obligations from global security

In order to limit the risks of global securities, paragraph (3) provides that only contractual obligations directly incurred by the debtor towards the creditor are covered. This provision excludes, in particular, the coverage of claims against the debtor which have been assigned to the creditor after the global security had been assumed. In addition, non-contractual claims are excluded from global security. Again, the parties are free to agree otherwise.

G. Consumer as security provider

Dependent personal security. If a consumer has assumed a dependent personal security, the present Article becomes mandatory in favour of the security provider by virtue of IV.G.–4:102 (Applicable rules) paragraph (2).

Other types of personal security. The provisions of paragraphs (1) and (2) of the present Article are fully applicable to a consumer's independent personal security (*cf.* IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (c)) and to a consumer's co-debtorship for security purposes (*cf.* IV.G.–4:102 (Applicable rules) paragraph (1)). A slight qualification is necessary for the words "if any" in paragraph (1) relating to the indication of a maximum amount of the security. According to IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (a), the amount of a consumer security provider's security must always be limited, and the limitation, if the parties have not provided for it, is to be effected according to IV.G.–2:102 (Dependence of security provider's obligation) paragraph (3). Therefore, in the present context the words "if any" are irrelevant.

By virtue of the references in IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (c), paragraph (3) of the present Article is also applicable where a consumer

assumes an independent personal security or a co-debtorship for security purposes. As in the case of a consumer provider of a dependent security, an agreement which according to its terms purports to cover all the debtor's obligations towards the creditor or the debit balance of a current account (a global security), is restricted to cover obligations which originated in contracts between the debtor and the creditor. An additional restriction in favour of consumer security providers follows from IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (a), according to which global securities of consumers must have a maximum limit, which either has been agreed by the parties or has to be determined according to IV.G.–2:102 (Dependence of security provider's obligation) paragraph (3).

The present Article is mandatory in favour of the consumer security provider, cf. cf. IV.G.–4:102 (Applicable rules) paragraph (2). And in the context of a consumer security provider's co-debtorship for security purposes the term "debtor" in the present Article means the debtor whose obligation is secured.

IV.G.–2:105: Solidary liability of security provider

Unless otherwise agreed, the liability of the debtor and the security provider is solidary and, accordingly, the creditor has the choice of claiming solidary performance from the debtor or, within the limits of the security, from the security provider.

COMMENTS

A. The general rule: solidary liability

The present Article expresses the basic form of the security provider's liability under these Rules, which is solidary. The creditor may choose to claim full performance from the debtor or the security provider. The creditor may also divide the claim and claim one part from the one and the other part from the other person. Technically, in some cases this may not be solidary liability, since the legal bases of the two obligations may differ; but the effect is comparable in some respects.

Solidary liability is established for this situation by most modern legislation and has always prevailed in commercial relations. Where older laws provide for the security provider's subsidiary liability, in practice this is usually replaced contractually by solidary liability.

B. Security on first demand

If a personal security is due on first demand it is a security with solidary liability. Typically, it will be an independent personal security, cf. IV.G.–3:103 (Independent personal security on first demand), unless the parties have expressly designated it as a dependent personal security. However, any first demand security which has been assumed by a consumer, is considered as creating a dependent security, provided the requirements of the latter are met, cf. IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (c).

C. Consumer as security provider

While for ordinary dependent security solidary liability of the security provider is the rule and subsidiary liability the exception, by virtue of IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (b) this relationship is reversed for a consumer's dependent security: the latter's liability as a rule is subsidiary; however, the parties may expressly agree

otherwise. This reversal is intended to grant better protection to the consumer who assumes a dependent personal security.

This rule applies to both a consumer's assumption of an independent personal security (cf. IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (c)) as well as to a consumer's co-debtorship for security purposes (cf. IV.G.–4:102 (Applicable rules) paragraph (1)). In the context of a consumer security provider's co-debtorship for security purposes the term "debtor" means the debtor whose obligation is secured.

IV.G.–2:106: Subsidiary liability of security provider

(1) If so agreed, the security provider may invoke as against the creditor the subsidiary character of the security provider's liability. A binding comfort letter is presumed to establish only subsidiary liability.

(2) Subject to paragraph (3), before demanding performance from the security provider, the creditor must have undertaken appropriate attempts to obtain satisfaction from the debtor and other security providers, if any, securing the same obligation under a personal or proprietary security establishing solidary liability.

(3) The creditor is not required to attempt to obtain satisfaction from the debtor and any other security provider according to the preceding paragraph if and in so far as it is obviously impossible or exceedingly difficult to obtain satisfaction from the person concerned. This exception applies, in particular, if and in so far as an insolvency or equivalent proceeding has been opened against the person concerned or opening of such a proceeding has failed due to insufficient assets, unless a proprietary security provided by that person and for the same obligation is available.

COMMENTS

A. Subsidiary liability as exception

Since according to the preceding Article solidary liability of a provider of dependent security is the rule, subsidiary liability requires an agreement of the parties. In case of doubt the security provider has to prove that the liability is merely subsidiary. Exceptionally, according to IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (b) a personal security given by a consumer is always subsidiary.

Binding comfort letter. A binding comfort letter is "presumed" to create only subsidiary liability. This presumption is derived from the fact that the author of such a letter does not assume a direct liability to make payment to the creditor but, typically merely promises to see to it that the debtor has sufficient funds to satisfy the debtor's obligations towards the beneficiary of the letter. Failure to keep this promise results merely in liability in damages to the creditor. Of course, the presumption of a merely subsidiary liability of the patron can be disproved by the creditor.

B. Effects of subsidiary liability

The effect of subsidiary liability as intended by these Rules is defined by paragraph (2). In the case of subsidiary liability, the security provider is protected against too early an imposition of liability towards the creditor. Before being allowed to turn against the security provider, the

creditor is required to have undertaken appropriate attempts to obtain satisfaction from several other possible sources. The subsidiary nature of a security provider's liability not only protects the security provider against a primary demand for performance under the security by the creditor but also gives provisional protection against attempts by other security providers, who have assumed solidary liability, to hold the security provider with subsidiary liability internally liable on recourse (cf. IV.G.-1:108 (Several security providers: internal recourse) paragraph (3) second alternative).

The appropriate attempts to obtain satisfaction which have to be undertaken by the creditor (or another security provider who might seek internal recourse) before claiming from a security provider with only subsidiary liability consist of the following requirements.

Firstly, the creditor must have tried to obtain satisfaction from the debtor. Only after having attempted an execution against the debtor may the creditor turn against the security provider for any obligation of the debtor which is still outstanding. Especially if the debtor has provided a proprietary security right, the creditor must attempt to satisfy the debt from this source.

Second, the creditor must have tried to enforce any personal or proprietary security rights granted by third parties for the same obligation which are not subsidiary. If another security provider has assumed solidary liability this shows a willingness to answer any demand for payment even though the creditor could well turn *e.g.* against the debtor. It is appropriate that a security provider who has assumed only a subsidiary liability should have to pay only if satisfaction cannot be obtained from a security provider of the "first rank".

C. Exceptions

In certain situations, a security provider who is only subsidiarily liable, is nevertheless not entitled to refuse performance to the creditor under the security even though the creditor has not undertaken all or some of the appropriate attempts to obtain satisfaction required under paragraph (2).

One self-evident case presents itself where all personal and proprietary securities are only subsidiarily liable. Provided that the creditor has undertaken appropriate attempts to obtain satisfaction from the debtor, the creditor can choose to claim performance from any of the security providers since their liability towards the creditor is solidary.

Other cases, in which it would be pointless to demand that the creditor first undertakes attempts to obtain satisfaction from the debtor or other security providers as required under paragraph (2) before claiming from the security provider with only subsidiary liability are dealt with in paragraph (3). This provision applies where it is obviously impossible or exceedingly difficult to obtain satisfaction from the debtor or other security providers who are solidarily or subsidiarily liable. In such a situation, a waste of time and money by the creditor must be avoided.

The most important example of a situation where it is obviously impossible or exceedingly difficult to obtain satisfaction from other persons is given in the second sentence of paragraph (3): insolvency or equivalent proceedings have been opened against the debtor or any other security provider or the opening of such a proceeding has failed due to insufficient assets. The mere chance to obtain some quota from the insolvent person's estate does not suffice since

such quotas are, generally speaking, low or very low. The creditor may not be limited to such chances since full satisfaction in the near future is virtually excluded. And security is meant to prevent just such a result.

However, even if insolvency proceedings have been opened, the creditor still has chances of obtaining satisfaction from the insolvent person, if that person had provided proprietary security rights for the creditor; therefore the second sentence of paragraph (3) provides for a counter-exception, where the creditor is not relieved from the requirements of paragraph (2).

Other situations falling under paragraph (3) first sentence not expressly mentioned could be cases where the asset which is subject to a proprietary security right is located outside the country of the debtor's (or any other security provider's) residence in a country outside the European Union and enforcement or execution would be difficult or time-consuming. Economic equivalents would be cases where the value of the encumbered asset has depreciated or where it is clearly inadequate to satisfy the creditor's claim or if the encumbered asset is obviously worthless.

D. Default security

Especially in commercial practice, performance by one security provider is frequently supported by a default security. This is furnished by a second security provider (often one residing in the creditor's country) which is assumed towards the creditor and can be utilised by the latter if the first security provider is unable or unwilling to perform. In this setting, the default security is subsidiary since it may only be invoked if the creditor's attempt to obtain satisfaction from the first security provider has failed.

E. Consumer as security provider

Contrary to the approach to ordinary dependent security a consumer who assumes a dependent personal security is as a rule liable only subsidiarily; cf. IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (b) and also Comment C to the preceding Article. This rule applies to a consumer who purports to provide an independent security (cf. IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (c)) as well as to a consumer who has assumed a co-debtorship for security purposes (cf. IV.G.–4:102 (Applicable rules) paragraph (1)).

Contrary to the general rule for consumer security providers, the basic principle of subsidiary liability may be deviated from by express agreement of the parties (cf. IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (b)). And in the context of a consumer security provider's co-debtorship for security purposes the term "debtor" means the debtor whose obligation is secured.

IV.G.–2:107: Requirement of notification by creditor

(1) The creditor is required to notify the security provider without undue delay in case of a non-performance by, or inability to pay of, the debtor as well as of an extension of maturity; this notification must include information about the secured amounts of the principal obligation, interest and other ancillary obligations owed by the debtor on the date of the notification. An additional notification of a new event of non-performance need not be given before three months have expired since the previous notification. No notification is required if an event of non-performance merely relates to ancillary obligations of the debtor, unless

the total amount of all non-performed secured obligations has reached five percent of the outstanding amount of the secured obligation.

(2) In addition, in the case of a global security, the creditor is required to notify the security provider of any agreed increase:

(a) whenever such increase, starting from the creation of the security, reaches 20 percent of the amount that was so secured at that time; and

(b) whenever the secured amount is further increased by 20 percent compared with the secured amount at the date when the last information according to this paragraph was or should have been given.

(3) Paragraphs (1) and (2) do not apply, if and in so far as the security provider knows or could reasonably be expected to know the required information.

(4) If the creditor omits or delays any notification required by this Article the creditor's rights against the security provider are reduced by the extent necessary to prevent the latter from suffering any loss as a result of the omission or delay.

COMMENTS

A. Information on debtor's default

In accordance with modern trends in the law on personal security, these rules impose certain requirements on the creditor; especially of information towards consumer providers of security even in the pre-contractual phase, if the creditor is to preserve full rights against the security provider.

According to paragraph (1) the creditor is required to inform the provider of a dependent security as soon as any critical situation arises with respect to the secured obligation which may lead to demands upon the security provider. The creditor must, in order to allow the security provider to evaluate the possible risk and request relief from the debtor, inform the security provider about a non-performance or inability to pay of the debtor or an extension of maturity of the secured obligation. In this notification the creditor must indicate the outstanding amounts of principal, interest and other ancillaries as of the date at which the information is given. If the default continues, the information must be renewed every three months after the preceding information.

According to the third sentence of paragraph (1), a notification is as a rule not required if merely an ancillary obligation has not been performed. The requirement of information, however, is revived, if the total of all unperformed secured obligations which are due amounts to five percent or more of the outstanding total of the secured obligations. In other words, while a certain percentage of due but unpaid ancillary obligations does not call for a reaction by the creditor, the percentage of five percent triggers the requirement to report according to paragraph (1).

B. Information by creditor of global security

The provider of a global dependent security is not protected by the Rules of IV.G.– 2:102 (Dependence of security provider's obligation) paragraph (4) against any increase of the secured amounts or aggravation of the secured obligation because this would run counter to the essence of a global dependent security. However, the security provider's legitimate interest in knowing the approximate extent of the risk must be satisfied by information about any major increases of the total amount of potential obligations agreed by the creditor. Since

information about the actual amount of indebtedness which may change daily is too burdensome, only major increases must be notified. The first “major” increase is fixed at 20 per cent over the amount of the secured obligations that were secured by the global security at the time of its creation. Correspondingly, subsequent “major” increases require notification to the security provider if they amount to an additional 20 percent over the secured amount at the time when the preceding information was given or should have been given.

C. Exception for informed provider of dependent security

The information requirements under paragraphs (1) and (2) are unnecessary if and in so far as the security provider is already informed, or can easily acquire the relevant information, e.g. as the director of the debtor company. The burden of proof for this exception must be borne by the creditor.

D. Sanction

The sanction for delaying or omitting altogether the information required under paragraphs (1) and (2) is spelt out in paragraph (4). The creditor’s rights against the security provider are reduced to the extent necessary to prevent the latter from suffering any loss as a result of the omission or delay. Such loss may arise if due to the omitted information the security provider will be unable to obtain relief or satisfaction from the debtor because the latter has in the meantime become insolvent.

E. Consumer as security provider

The present Article is a provision for the protection of the security provider; as such, it is applicable not only to a dependent security assumed by a consumer security provider but also to a consumer’s purported assumption of an independent personal security (cf. IV.G.–4:105 (Nature of security provider’s liability) sub-paragraph (c)) as well as to a consumer’s co-debtorship for security purposes (cf. IV.G.–4:102 (Applicable rules) paragraph (1)).

Although there is a specific rule limiting global securities assumed by consumer security providers (IV.G.–4:105 (Nature of security provider’s liability) sub-paragraph (a)), the additional protection provided for by paragraph (2) fulfils an important role also in the consumer context. The creditor is required to inform the consumer security provider of any increase of the secured obligation, even if this does not exceed the maximum limit which in the consumer context a global security must have.

According to IV.G.–4:102 (Applicable rules) paragraph (2), the rules of the present Article are mandatory in favour of the consumer. And in the context of a consumer security provider’s co-debtorship for security purposes the term “debtor” means the debtor whose obligation is secured.

IV.G.–2:108: Time limit for resort to security

(1) If a time limit has been agreed, directly or indirectly, for resort to a security establishing solidary liability for the security provider, the latter is no longer liable after expiration of the agreed time limit. However, the security provider remains liable if the creditor had requested performance from the security provider after maturity of the secured obligation but before expiration of the time limit for the security.

(2) If a time limit has been agreed, directly or indirectly, for resort to a security establishing subsidiary liability for the security provider, the latter is no longer liable after the expiration of the agreed time limit. However, the security provider remains liable if the creditor:

(a) after maturity of the secured obligation, but before expiration of the time limit, has informed the security provider of an intention to demand performance of the security and of the commencement of appropriate attempts to obtain satisfaction as required according to IV.G.–2:106 (Subsidiary liability of security provider) paragraphs (2) and (3); and

(b) informs the security provider every six months about the status of these attempts, if so demanded by the security provider.

(3) If performance of the secured obligations falls due upon, or within 14 days before, expiration of the time limit of the security, the request for performance or the information according to paragraphs (1) and (2) may be given earlier than provided for in paragraphs (1) and (2), but no more than 14 days before expiration of the time limit of the security.

(4) If the creditor has taken due measures according to the preceding paragraphs, the security provider's maximum liability is restricted to the amount of the secured obligations as defined in IV.G.–2:104 (Coverage of security) paragraphs (1) and (2). The relevant time is that at which the agreed time limit expires.

COMMENTS

A. General

Provisions on time limits. This Article and the following one deal with dependent securities with or without time limits. While this Article is applicable where the parties have agreed on a time limit for resort to a security, the following Article provides for a possibility to limit the scope of a security in respect of the coverage of future obligations in cases without an agreed time limit. IV.G.–4:107 (Limiting security with time limit), which is applicable for consumer security providers only, extends this possibility to certain securities with an agreed time limit.

Other consequences of agreed time limits. Not all consequences of agreed time limits are spelt out in these two Articles. Depending on the type of time limit in question, a main effect is typically to restrict the scope of a security in respect of the coverage of future obligations. As this consequence directly flows from the agreement of the parties and depends on the terms of this agreement, it appears to be neither necessary nor possible to regulate this effect in the text of the Rules.

B. Types of time limits

Common features. While the parties can agree on different types of time limits for their security, such time limits share a common objective as a means to limit the security provider's liability, and hence risk, under the security. Moreover, the existence of any type of agreed time limit for a security typically precludes the possibility to unilaterally limit the security according to IV.G.–2:109 (Limiting security without time limit). Cf. the Comments on that Article.

Time limits restricting the scope of the security. In one type of time limit, only the scope of the security is limited, e.g. the coverage of the security is limited to secured obligations arising, falling due or fulfilling other requirements before the expiration of the agreed time limit (such a time limit could for instance be agreed using the following formula: "This security is valid only for secured obligations arising until August 31"). Thus, even if a

security provider assumes a security for obligations of the debtor that at the moment of the creation of the security are not yet in existence and whose scope is not known, especially in cases of global securities, the risk might be limited by excluding such obligations that do not arise or do not fall due or fulfil other requirements within a foreseeable period of time, *i.e.* before expiration of the agreed time limit. These effects are dealt with below. Such a type of time limit is not subject to the present Article, however, since the parties did not agree on a time limit for the creditor's right to rely on the security vis-à-vis the security provider.

Time limits for resort to security. The type of time limit covered by the present Article focuses not on the scope of a security, but on the creditor's right to resort to the security. By setting a time limit for resort to the security, whether directly (*e.g.* "The creditor may rely on this security until May 31") or indirectly (*e.g.* "This security expires 6 months after maturity of the secured obligation"), the risk assumed by the security provider in relation to the solvency of the debtor is limited to a period of time which is specified in the agreement or can be indirectly determined, *i.e.* until expiration of the agreed time limit in question. However, such a time limit typically also affects the scope of the security, *i.e.* restricts the scope of the security in respect of the coverage of future obligations.

Both types of time limits independent from each other. It has to be emphasised that these two types of time limits are quite independent from each other. A variety of combinations is possible, depending upon the construction of the agreement of the parties. The parties may have agreed on a time limit restricting the scope of the security, but may at the same time not have intended to restrict the possibility of resorting to the security. In special cases there might also be a time limit for resort to the security that does not give rise to a restriction of the scope of the security. It is also possible to have two separate agreed time limits for a single security: *e.g.* one restricting the scope of the security to obligations arising until expiration of this time limit, and a second one setting a (subsequent) time limit for resort to the security. In other cases, finally, one and the same reference to a limit may have to be regarded as restricting at the same time the possibility of resorting to the security and the scope of the security. See Comment H below.

C. Time limit for resort to security

Matter of construction. The existence of a time limit for resort to a security is, unless it is clearly set out, largely a matter of construction of the parties' agreement. If the parties do not expressly refer to a time limit as being one for resort to a security, the following considerations might be of some assistance.

Indication for time limit for resort to security. As a rule of thumb, the fact that the personal security in question covers only existing obligations or specific future obligations will be an indication that an agreed time limit constitutes a time limit for resort to the security. In such cases, there seems to be less of a need for a security provider to seek to be protected against a liability of an unforeseeable amount on the basis of future obligations of the debtor; rather, it is the additional protection of a time limit for resort to the security which limits the period of time during which the security provider assumes the risk of the debtor's solvency that might be of any interest for the security provider.

Date of maturity of secured obligations. A mere reference to the date of maturity of the secured obligations typically does not give rise to a time limit for resort to the security. Otherwise the creditor would lose the protection provided by the personal security by failing

to immediately enforce the secured obligation or the security as soon as the secured obligation became due.

D. Consequences of expiration of time limit for resort to security

General rule: extinction of liability. The general rule is that if a time limit has been agreed for resort to a security, the security provider is no longer liable towards the creditor after expiration of the agreed time limit. For contracts of personal security establishing solidary liability, this is provided for in paragraph (1) sentence 1; in cases of subsidiary liability of the security provider paragraph (2) sentence 1 applies. This extinction of liability not only bars any liability of the security provider under the security for future obligations of the debtor, but also affects obligations already in existence: the security provider is no longer liable towards the creditor even in relation to obligations covered by the security that have become due by the time the agreed time limit expires.

Continuation of liability if additional requirements are fulfilled. The security provider remains liable towards the creditor after the expiration of the agreed time limit only if additional requirements are fulfilled. Generally speaking, only if the creditor has acted timeously upon the security in such a manner as to hold the security provider liable according to the terms of the security in question will the security provider's liability with respect to existing obligations not be extinguished. The details of the requirements to be fulfilled in this respect differ between situations of solidary liability of the security provider and those of subsidiary liability of the latter. See below.

Security provider's maximum liability determined by paragraph (4). Even if the creditor has in good time fulfilled the requirements for the continuation of the security provider's liability, this liability is restricted. According to paragraph (4), the security provider's maximum liability is limited to the amount of the secured obligations upon expiration of the agreed time limit. Principal and ancillary obligations are covered, however, only within the further limitation of an agreed maximum amount for the security, if any. For the determination of the maximum amount of the liability, any defences available vis-à-vis the creditor at the time at which the agreed time limit expires, have to be taken into account; thus, the amount of secured obligations that are not due yet does not increase the maximum amount of the security provider's liability.

Scope of security restricted according to terms of time limit. Also in case of a time limit for resort to the security, there will typically be an additional restriction of the scope of the security according to the terms of the parties' agreement.

E. Continuation of liability in case of solidary liability

Request for performance. If the security provider had assumed solidary liability, the creditor only has to request performance from the security provider in good time in order for the latter to remain liable even after expiration of the agreed time limit (paragraph (1) sentence 2). A simple declaration by the creditor suffices; it is not necessary in this context that the creditor commences legal action against the security provider.

Time for request. The request is effective for this purpose only if it is made after maturity of the secured obligation but before expiration of the agreed time limit (paragraph (1) sentence 2). The first requirement, that the request must be made before expiration of the agreed time limit, is the essence of a personal security with a time limit for resort to the security: the

security provider assumes the risk of the debtor's solvency only until the agreed time limit; should the creditor at a later point of time discover that due to the debtor's insolvency performance can only be expected from the security provider, this is no longer covered by the terms of this security, even if the secured obligation in question came into existence in time. The second requirement as to the time for the request for performance, *i.e.* that the request must be made after maturity of the secured obligation, has been introduced in order to prevent the request for performance becoming a mere formality for the creditor to be made already at the time of creation of the security: the request can be made in earnest only if the secured obligation is due. Specific provision is made for secured obligations becoming due upon, or within fourteen days before expiration of the time limit.

F. Continuation of liability in case of subsidiary liability

General. A security provider who is subsidiarily liable remains liable even after expiration of the agreed time limit only if the creditor has fulfilled stricter requirements than in the case of solidary liability of the security provider. The rationale is obvious: in the situation of subsidiary liability, the security provider is liable towards the creditor only if the latter has fruitlessly attempted to obtain satisfaction from the debtor or other security providers with solidary liability, if any. If additionally a time limit for resort to the security has been agreed, it follows that the creditor has to show that these requirements have been fulfilled before expiration of the agreed time limit.

Appropriate attempts to obtain satisfaction. According to paragraph (2)(a) the creditor must have started to undertake appropriate attempts to obtain satisfaction as required by IV.G.-2:106 (Subsidiary liability of security provider) paragraphs (2) and (3). The reference to paragraph (3) imports the exceptions provided for in that paragraph. Thus, in situations where the security provider may not invoke the subsidiary character of the liability vis-à-vis the creditor even though the latter has not attempted to obtain satisfaction from the debtor or any other security provider, as the case might be, the creditor does not have to start such attempts for the purposes of paragraph (2)(a) of the present Article either. It has to be emphasised that the attempts required by paragraph (2)(a) need not be completed – for the purposes of this provision it is sufficient that the creditor has started to undertake such attempts since demanding (fruitless) completion of these attempts to obtain satisfaction from other sources would be too onerous and time-consuming for the creditor.

Information required according to paragraph (2)(a). According to paragraph (2)(a) the creditor firstly has to inform the security provider of an intention to demand performance. In contrast to paragraph (1) sentence 2 no request for performance is necessary since in the situation dealt with by paragraph (2)(a) the security provider might still be able to rely on the subsidiary character of the liability. Additionally, the creditor has to assert that the attempts described in the preceding paragraph have started.

Time for information. As in the situation of solidary liability of the security provider, the information required according to paragraph (2)(a) has to be given after maturity of the secured obligation, but before expiration of the agreed time limit. See Comment G below for the situation of the secured obligations becoming due upon, or within fourteen days before expiration of the agreed time limit.

Information required according to paragraph (2)(b). If the security provider so demands, the creditor also has to inform the security provider every six months about the status of the

attempts to obtain satisfaction. This is a continuing obligation, *i.e.* if the creditor should even after expiration of the agreed time limit fail to comply with this requirement until completion of these attempts, then the security provider is no longer liable towards the creditor.

G. Maturity of secured obligations close to expiration of time limit

Modification of time for request or information. In certain situations, the point of time at which the request has to be made or the information to be given according to paragraphs (1) and (2) does not seem practicable: should the secured obligations become due only upon, or within a short period of time before expiration of the agreed time limit, the security provider might have only a very limited possibility to consider the options before having to turn against the security provider in order to avoid the loss of rights against the latter. Paragraph (3) applies in these situations and makes sure that the creditor has at least a period of fourteen days to make the request or to inform the security provider before the time limit of the security expires.

H. Time limit restricting scope of security

Legal basis. Agreed time limits typically also restrict the scope of the security with respect to the coverage of future obligations. This consequence is not limited to time limits for resort to a security within the meaning of the present Article: it flows directly from the agreement of the parties and is therefore not spelt out in the text of the Rules.

Existence of time limit restricting scope of security. Whether a reference to a time limit in the agreement of the parties is to be regarded as a time limit that restricts the scope of the security with respect to the coverage of future obligations is once more, unless clearly spelt out by the parties, a matter of construction of the agreement. In general every agreement by the parties including a time limit which has the effect of excluding future obligations – whether these are obligations arising or falling due or fulfilling other requirements after a certain date – from the scope of the security, is to be regarded as a time limit in this sense.

Time limits for resort to security. Time limits for resort to the security do typically also have the effect of restricting the scope of the security in the sense of the preceding paragraph. This follows from the fact that where a creditor is bound to resort to the security before expiration of a certain time limit, the creditor will after that point of time no longer be able to rely on the security in respect of any future obligations. There are, however, exceptions to this rule: agreements of the type “This security for all future indebtedness of the debtor towards the creditor expires in respect of each individual obligation secured 6 months after maturity of that obligation” do not provide for a time limit for the security as a whole. Thus such time limits do not restrict the scope of the security with respect to the coverage of future obligations.

Duration of agreement giving rise to secured obligation as time limit. The mere fact that the agreement from which the secured obligation arises has a time limit should not in itself be regarded as indirectly giving rise to a time limit for the security. It should be noted, however, that even if such securities are regarded as unlimited, in cases where the security is restricted to cover obligations arising from specific contracts the applicability of IV.G.–2:109 (Limiting security without time limit) is excluded according to paragraph (1) sentence 2, cf. Comments on that Article.

Restriction of coverage of security. The effect of a time limit for the security is that the scope of security is limited accordingly, *i.e.* only those secured obligations are covered which are not excluded by virtue of the agreed time limit. The details depend upon the terms of the parties' agreement: the coverage of the security could be restricted to obligations that arise or fall due or fulfil other requirements until that time, whatever the terms of the agreed time limit might be. Since IV.G.–2:109 (Limiting security without time limit) is inapplicable in any of these cases, there is no possibility for the parties on the basis of that provision to unilaterally set an earlier time limit by giving notice (*cf.*, however, the exception provided for in IV.G.–4:107 (Limiting security with time limit) for consumer security providers).

Restriction of scope of security in case of a time limit for resort to security. In the case of a time limit such as “The creditor may resort to this security until August 31” or “This security expires August 31” it might not be easily determinable from the terms of the time limit whether the security is intended to cover secured obligations that have arisen, but are not due yet at that point of time. It is submitted that in general such time limits within the meaning of the present Article will restrict the liability of the security provider to secured obligations that have fallen due since only in respect of such obligations can the requirements of paragraph (1) sentence 2 and paragraph (2) sentence 2 be fulfilled. The additional restriction of the amount of the security provider's maximum liability according to paragraph (4) of the present Article, however, will often make a decision on this point unnecessary.

I. Consumer as security provider

Applicability to all types of consumer security providers. Chapter 4 does not contain any specific provisions on time limits for resort to security; therefore, the present Article is applicable directly and without modifications to consumer providers of dependent security. The same result is achieved for consumer providers of independent security (*cf.* IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (c)) and for consumer security providers in a co-debtorship for security purposes (*cf.* IV.G.–4:102 (Applicable rules) paragraph (1)). The application of the present Article to the last-mentioned type of consumer security providers is justified because the Article is favourable to them in so far as this rule provides legal certainty; otherwise it would be necessary to turn to uncertain general principles of contract law in order to determine the scope and the effect of an agreed time limit for resort to security.

Mandatory character. By virtue of IV.G.–4:102 (Applicable rules) paragraph (2), the present Article is mandatory in favour of all types of consumer security providers.

IV.G.–2:109: Limiting security without time limit

(1) Where the scope of a security is not limited to obligations arising, or obligations performance of which falls due, within an agreed time limit, the scope of the security may be limited by any party giving notice of at least three months to the other party. The preceding sentence does not apply if the security is restricted to cover specific obligations or obligations arising from specific contracts.

(2) By virtue of the notice, the scope of the security is limited to the secured principal obligations performance of which is due at the date at which the limitation becomes effective and any secured ancillary obligations as defined in IV.G.–2:104 (Coverage of security) paragraphs (1) and (2).

COMMENTS

A. General

Provisions on time limits. This Article deals with dependent personal securities which do not have a time limit, *i.e.* that cover future secured obligations over an indefinite period. In accordance with the general principle contained in III.–1:109 (Variation or termination by notice) paragraph (2), the present Article provides for a possibility to limit the duration of such a security, *i.e.* to limit the scope of the security to obligations performance of which is due at the time when the limitation becomes effective. An additional provision, IV.G.–4:107 (Limiting security with time limit), is applicable for consumer security providers only.

Limitation of duration of security outside scope of Article. The duration of a security might be unilaterally limited by any of the parties to the agreement even outside the scope of the present Article, *e.g.* where the parties have provided for such a right to limit the duration of a security in their agreement. In such situations, the Article may nevertheless be applicable in order to determine details or consequences of such a contractual term.

B. Security without agreed time limit

The Article provides for a possibility to limit the scope of a security in cases where such a restriction does not already follow from a time limit agreed by the parties. Whether a security is unlimited in this way must be determined by interpreting the parties' agreement. This issue is dealt with in Comment C to the preceding Article. Generally, the existence of any type of time limit for the security leads to the inapplicability of the present Article, the only exception being such time limits as do not affect the security as a whole, *e.g.* time limits which apply to certain secured obligations only. For consumer security providers, cf. IV.G.–4:107 (Limiting security with time limit).

C. Limitation by giving notice

Declaration by any party sufficient. Any party may limit the security, *i.e.* limit its scope to secured obligations due at the time when the limitation becomes effective by simple declaration vis-à-vis the other party. An act of the court is not necessary, neither does the party have to show the existence of good reasons. Although the Article gives both the creditor and the security provider the right to limit the security, in fact it will typically only be the security provider who exercises this right.

Notice period. The limitation of the security by giving notice can become effective only after a period of at least three months that has to be set by the party giving notice has expired. This minimum length of the period of notice has been introduced in order to protect the interests of the creditor and the debtor: typically, if the security provider limits a security covering future obligations the creditor will immediately stop granting any further credit to the debtor which might cause short-term illiquidity of the latter. The three months period of notice should give the debtor the opportunity to arrange alternative security or credit from another source. The security provider is protected by the principle of good faith against any undue increases of the secured obligations agreed between debtor and creditor within this period (if covered at all, cf. IV.G.–2:102 (Dependence of security provider's obligation) paragraph (4)).

D. Effect of limitation of security

Secured principal obligations due at the time the limitation becomes effective. If notice is given, the scope of the security provider's liability is restricted to secured obligations that are

due as of the date at which the limitation becomes effective. The limitation by giving notice in this respect has similar effects to those of an agreed time limit according to which the scope of the security would cover secured obligations that arise or fall due or fulfil other requirements before expiration of the time limit. For the purposes of this Article, it is thought to be preferable to restrict the liability of the security provider to secured principal obligations that are due as of the date at which the limitation becomes effective, since this is the solution that is most favourable to the security provider. Moreover, the fact that a dependent personal security is limited according to this Article will typically give the creditor the right to accelerate the maturity of obligations secured by this security that have arisen but are not yet due, such as a credit paid out to the debtor that under its original terms was repayable at a date after the three months.

Secured ancillary obligations covered even though arising or falling due at a later time.

The requirement that secured obligations must be due as of the date at which the limitation becomes effective does, however, only apply to the secured principal obligations. Ancillary obligations as defined in IV.G.-2:104 (Coverage of security) paragraphs (1) and (2) are covered by the scope of the security even if they arise or fall due at a later point of time. These obligations typically arise and fall due later than the principal obligation; in the absence of an agreement to the contrary it would seem unreasonable that a security should cover a secured principal obligation, but not *e.g.* interest owed by the debtor in respect of that obligation even if accruing only after the limitation of the security became effective, since the source of the obligation to pay interest is the non-payment of the principal obligation.

Limitation does not create time limit for resort to security. The limitation of the security according to this Article does not, however, create a time limit for resort to the security, *i.e.* the security provider remains liable after the limitation of the security even if the creditor does not take any further action until that date. Should the parties also have agreed on a time limit for resort to the security, then this time limit is not affected by the fact that a party exercises the right conferred by the present Article.

E. Exceptions

Cases outside scope of the Article. Paragraph (1) second sentence sets out situations in which the parties may not unilaterally limit the scope of the security by giving notice. If the security is agreed to cover specific obligations or obligations arising from specific contracts the exercise of the right according to the Article by the security provider would run counter to the interests of the creditor who may have agreed to contract with the debtor only on the basis of the existence of a dependent security and who may not be able to terminate the relationship resulting from the agreement. The creditor could, for example, have entered into a contract for the lease of an apartment only on the strength of a security provided in relation to the debtor's obligations to pay rent. According to the Article it is not possible to unilaterally limit the duration of a security in such a situation regardless of whether the lease contract itself has a time limit or is concluded for an indefinite period. The main example of a dependent security not covered by these exceptions (and therefore subject to the parties' right to give notice) is a global security. It is clear that for a security covered by one of these exceptions, recourse to the general principle of III.-1:109 (Variation or termination by notice) paragraph (2) is not possible: *lex specialis derogat legi generali* (see I.-1:102 (Interpretation and development)).

Other bases of protection of security provider. In certain situations, the exclusion of the right to limit a security by giving notice might cause hardship to the security provider. It is assumed, however, that in appropriate circumstances protection for the security provider

against an unreasonable duration of a security could be offered on other legal bases. Apart from the possible application of the rules on change of circumstances (cf. III.–1:110 (Variation or termination by court on a change of circumstances)), the creditor might in certain cases be prohibited from relying on a security running over an excessively lengthy period of time on the basis of the principle of good faith (cf. III.–1:103 (Good faith and fair dealing)); in other situations it is not inconceivable that the right to relief (IV.G.–2:111 (Debtor’s relief for the security provider)) might include a right to demand that the debtor terminates the contractual relationship comprising the secured obligation in order to prevent the creation of new secured obligations which would increase the security provider’s liability.

F. Consumer as security provider

Applicability to all types of consumer security providers. This Article is directly applicable to consumer providers of dependent security and allows them to limit securities given for an unlimited time, subject to the exceptions provided for in paragraph (1) sentence 2. The protection of consumer security providers is supplemented by IV.G.–4:107 (Limiting security with time limit), which allows the security provider to limit securities with an agreed limit under the conditions set out in that provision. These principles also apply to consumer providers of independent security (cf. IV.G.–4:105 (Nature of security provider’s liability) sub-paragraph (c)) and to consumer security providers in a co-debtorship for security purposes (cf. IV.G.–4:102 (Applicable rules)). The application of the present Article to these types of security providers includes the exceptions provided for in paragraph (1) sentence 2.

Mandatory character. By virtue of IV.G.–4:102 (Applicable rules) paragraph (2), the present Article may not be deviated from to the detriment of a consumer security provider in any type of security.

IV.G.–2:110: Reduction of creditor’s rights

(1) If and in so far as due to the creditor’s conduct the security provider cannot be subrogated to the creditor’s rights against the debtor and to the creditor’s personal and proprietary security rights granted by third persons, or cannot be fully reimbursed from the debtor or from third party security providers, if any, the creditor’s rights against the security provider are reduced by the extent necessary to prevent the latter from suffering any loss as a result of the creditor’s conduct. The security provider has a corresponding right to recover from the creditor if the security provider has already performed.

(2) Paragraph (1) applies only if the creditor’s conduct falls short of the standard of care which could be expected of persons managing their affairs with reasonable prudence.

COMMENTS

A. Basic idea

Since a security provider usually assumes the security without remuneration, the security provider should, if obliged to perform to the creditor, be able to seek reimbursement from the debtor. IV.G.–2:113 (Security provider’s rights after performance) makes various rights available to the security provider: a claim for reimbursement according to paragraph (1) first sentence as well as a subrogation to the creditor’s rights against the debtor, both the personal

rights (paragraph (1) second sentence) and the personal and proprietary rights securing this latter claim (paragraph (3)).

The present Article deals with the consequences if, due to the conduct of the creditor, these rights are lost or are diminished and therefore cannot pass fully or partly to the security provider, after the latter has performed to the creditor. Such conduct may result in the creditor being deprived of rights against the security provider.

B. Details

The rule in this Article may come into operation in various ways. One typical example is that the creditor delays collection of a sum which is due by the debtor, although well aware that the debtor's financial situation is worsening. If the creditor waits until the debtor has become insolvent before demanding payment from the provider of dependent security, the creditor will lose the right to proceed against the security provider to the extent that the latter has, because of the creditor's conduct, lost the right to be reimbursed from the debtor's insolvent estate. Another example is that the creditor, believing that the debtor will remain solvent, gives up a personal or proprietary security against the debtor who later, against expectations, becomes bankrupt. Another typical instance occurs where the creditor negligently allows a security right against the debtor to deteriorate or to disappear, especially if, as is usually the case, the encumbered assets are held by the debtor.

Which yardstick is appropriate in order to determine how carefully the creditor must act in order to avoid losing rights against the security provider? Paragraph (2) makes it clear that the standard is that which could be expected of persons managing their affairs with reasonable prudence. This is an objective standard which does not depend on, for example, the creditor's abilities or professional experience. However, it requires some negligence on the creditor's part. A creditor who fails to take action when no reasonable person would be expected to do so will not lose rights. This is important for security providers too because the present Article is applied by reference in IV.G.-1:109 (Several security providers: recourse against debtor).

If the creditor prejudices the security provider's position by failing to preserve rights where this could reasonably be expected, the sanction may consist of a (*pro tanto*) discharge of the dependent security provider or by granting the security provider a claim for damages for breach of an obligation or duty imposed on the creditor. The former alternative has been chosen since it seems undesirable to place an *obligation* or *duty* on a creditor to protect the creditor's own interests and to place a creditor with a security in a potentially worse position (by virtue of an award of damages which might surpass the amount of the security) than a creditor without a security. In practice the two solutions would almost always lead to the same results.

C. Application to recourse claims

It should be noted that the rules of this Article are also applied with appropriate adaptations in the context of recourse claims as between several security providers. Where a security provider acts so as to deprive another security provider of the possibility of having secondary recourse against the debtor or of sharing any benefits recovered from the debtor, the former security provider may find that rights of recourse are correspondingly reduced, cf. Comments on IV.G.-1:109 (Several security providers: rights against debtor).

D. Consumer as security provider

The Article, as a rule protecting the security provider applies to a consumer who has provided a dependent personal security, one who has purported to assume an independent personal security (cf. IV.G.–4:105 (Nature of security provider’s liability) sub-paragraph (c)) and for consumer security providers in a co-debtorship for security purposes (cf. IV.G.–4:102 (Applicable rules) paragraph (1)). According to IV.G.–4:102 (Applicable rules) paragraph (1), the rules of this Article are mandatory in favour of the consumer. And in the context of a consumer security provider’s co-debtorship for security purposes the term “debtor” in the Article means the debtor whose obligation is secured.

IV.G.–2:111: Debtor’s relief for the security provider

(1) A security provider who has provided a security at the debtor’s request or with the debtor’s express or presumed consent may request relief by the debtor:

- (a) if the debtor has not performed the secured obligation when performance became due;*
- (b) if the debtor is unable to pay or has suffered a substantial diminution of assets; or*
- (c) if the creditor has brought an action on the security against the security provider.*

(2) Relief may be granted by furnishing adequate security.

COMMENTS

A. The principle

Under certain conditions, the provider of a dependent security may demand relief from the debtor even before the security provider has in fact performed to the creditor. Such exceptional “preceding” relief presupposes, however, that the security provider had assumed the security upon the demand of the debtor or with the debtor’s actual or presumed consent (e.g., by virtue of benevolent intervention) – this, of course, will almost always be the case, except in the rare situation of assuming a personal security as a gift to the debtor. In this latter case, any claim of the security provider for relief from the debtor is excluded.

In many cases, the provider of a dependent security may not be prepared to assume a security, unless a potential claim for reimbursement against the debtor is secured from the very beginning, e.g. by a personal counter security furnished by a third person or by a proprietary security, furnished either by the debtor or a third person.

B. Conditions

The conditions for requesting relief from the debtor are exhaustively enumerated in paragraphs (1)(a), (b) and (c). The condition in (a) refers to the debtor’s non-performance of the secured obligation upon maturity, since this may easily trigger the creditor’s demand upon the security provider. The condition in (b) refers to the debtor’s financial position. It covers the debtor’s inability to pay (even if no insolvency proceeding has been opened) because this virtually precludes the creditor’s recovery from the debtor; and it covers the situation where the debtor’s assets have been substantially diminished – a fact that threatens the creditor’s chances of successful recovery from the debtor and therefore increases the security provider’s risk of being held liable by the creditor on the one hand and of having small chances of recuperating from the debtor, on the other hand. The substantial diminution which is required must be measured by the amount of the creditor’s outstanding claims and the chances of realising a claim for reimbursement from the debtor’s assets. The condition in (c) refers –

independently of the conditions in (a) and (b) – to an action for performance brought by the creditor against the dependent security giver. This clearly justifies relief by the debtor.

The chances of obtaining relief from the debtor personally will usually be small. But the debtor may be able to raise money or at least personal or proprietary security from a third party, *e.g.* a relative or a related company.

C. Form of relief

Since in all the cases mentioned in paragraph (1), the provider of a dependent security has not yet performed to the creditor, the security provider cannot demand payment. Primarily the security provider is entitled to demand security for future performance to the creditor (cf. paragraph (2)). Such security may be granted by the debtor or by any third person on behalf of the debtor; the latter alternative will practically be the rule in the situations covered by paragraph (1)(a) because the debtor in these cases usually will not be able to furnish security.

If an insolvency proceeding has been opened over the debtor, a claim for relief will in fact be without chances.

D. Consumer as security provider

The Article is directly applicable to consumer providers of dependent security. Since the Article is favourable for consumer security providers, the rule also applies to consumers who have assumed an independent personal security (cf. IV.G.–4:105 (Nature of security provider’s liability) sub-paragraph (c)) and to consumer security providers in a co-debtorship for security purposes (cf. IV.G.–4:102 (Applicable rules) paragraph (1)).

According to According to IV.G.–4:102 (Applicable rules) paragraph (2), the rules of the present Article are mandatory in favour of the consumer. And in the context of a consumer security provider’s co-debtorship for security purposes the term “debtor” means the debtor for whom security is being provided.

IV.G.–2:112: Notification and request by security provider before performance

(1) Before performance to the creditor, the security provider is required to notify the debtor and request information about the outstanding amount of the secured obligation and any defences or counterclaims against it.

(2) If the security provider fails to comply with the requirements in paragraph (1) or neglects to raise defences communicated by the debtor or known to the security provider from other sources, the security provider’s rights to recover from the debtor under IV.G.–2:113 (Security provider’s rights after performance) are reduced by the extent necessary to prevent loss to the debtor as a result of such failure or neglect.

(3) The security provider’s rights against the creditor remain unaffected.

COMMENTS

A. Basic idea

This Article introduces requirements of notification and inquiry before the provider of a dependent security performs to the creditor. The requirements are introduced in order to protect the rights of the debtor.

The requirements of notification and inquiry imposed by paragraph (1) must be interpreted in the light of the rights pertaining to the debtor that according to earlier Articles may be invoked by the provider of a dependent security on the strength of the principle of dependency.

B. Sanctions

If the provider of a dependent security performs to the creditor without having informed the debtor and made relevant inquiries this is not only contrary to the security provider's own interests, but may damage the debtor's rights. The same is true if the security provider neglects to raise debtor's defences which are available to the security provider. In all these cases, the security provider's rights to reimbursement or subrogation against the debtor will be reduced correspondingly.

If the debtor fails to reply to the security provider or gives incomplete or incorrect information, the sanction indicated by paragraph (2) is not justified. Alternatively, it may be justified only in part if the debtor had given some wrong information, but other information, although correct, had been overlooked or disregarded by the security provider.

The sanction imposed by paragraph (2) on the security provider is an appropriate reduction of the rights to recover from the debtor.

C. Preservation of rights as against creditor

Any mistakes which may be committed by the provider of the dependent security vis-à-vis the debtor do not affect the security provider's rights as against the creditor (paragraph (3)).

D. Consumer as security provider

This Article is directly applicable to consumer providers of a dependent personal security, which are not treated differently from non-consumers in this respect; the only difference is that the provision is mandatory in favour of the consumer security provider according to IV.G.-4:102 (Applicable rules) paragraph (2).

Although the present Article does not create rights for but introduces requirements to be observed by a security provider, nevertheless these rules also apply to all consumer security providers. They apply directly to consumers who provide a dependent personal security. By virtue of IV.G.-4:105 (Nature of security provider's liability) sub-paragraph (c) they also apply to consumer providers of an independent security and by virtue of IV.G.-4:102 (Applicable rules) (1) to consumer providers of a co-debtorship for security purposes. The requirements laid down in the Article are necessary ingredients of a well-balanced system of personal security where the security provider must respect the legitimate interests of the principal debtor. The information by the security provider may be beneficial to the debtor since in appropriate cases it may prevent or reduce a performance by the security provider if it

turns out that the debtor has already made partial or even full performance to the creditor or has defences of which the security provider also may take advantage.

IV.G.–2:113: Security provider’s rights after performance

(1) The security provider has a right to reimbursement from the debtor if and in so far as the security provider has performed the security obligation. In addition the security provider is subrogated to the extent indicated in the preceding sentence to the creditor’s rights against the debtor. The right to reimbursement and rights acquired by subrogation are concurrent.

(2) In case of part performance, the creditor’s remaining partial rights against the debtor have priority over the rights to which the security provider has been subrogated.

(3) By virtue of the subrogation under paragraph (1), dependent and independent personal and proprietary security rights are transferred by operation of law to the security provider notwithstanding any contractual restriction or exclusion of transferability agreed by the debtor. Rights against other security providers can be exercised only within the limits of IV.G.–1:108 (Several security providers: internal recourse).

(4) Where the debtor due to incapacity is not liable to the creditor but the security provider is nonetheless bound by, and performs, the security obligation, the security provider’s right to reimbursement from the debtor is limited to the extent of the debtor’s enrichment by the transaction with the creditor. This rule applies also if a debtor legal entity has not come into existence.

COMMENTS

A. Survey

This Article deals with the rights of the security provider after having fully or partly performed the security obligation to the creditor. Paragraphs (1) to (3) regulate the “normal” consequences of such performance, whereas paragraph (4) deals with the special case of a performance in favour of a debtor who is incapable. It can be taken for granted that a security provider who “volunteers” payment knowing that performance of the security obligation is not due (for example, because of the expiry of a time limit on it or the non-fulfilment of a suspensive condition) is not regarded for this purpose as performing the security obligation but is rather in the position of someone making a gift. Such a security provider should not have rights under the present Article.

The Article regulates the ordinary case of a payment by a security provider to the creditor. The situation becomes more complicated if several security providers are involved, and possibly providers both of personal and of proprietary security. Before attempting to recover from the debtor who at this stage usually is insolvent, the security provider who has satisfied the creditor may wish to proceed against one or more of the other security providers since these may be in a better financial position than the debtor. The issues of such recourse against other security providers and, eventually, against the debtor are primarily regulated by IV.G.–1:108 (Several security providers: internal recourse) and IV.G.–1:109 (Several security provider’s recourse against the debtor) since they may involve providers not only of personal, but also of proprietary security. The present Article is relevant; however, in that context in so far as it determines which rights against the debtor and against other security providers become available as the basis of this recourse.

B. Right to reimbursement and subrogation

Under paragraph (1) the security provider who has performed the security obligation has a right to reimbursement from the debtor in so far as the obligation has been performed. The security provider is also subrogated to all personal (and proprietary rights, cf. paragraph (3)), which the creditor had held against the debtor, especially contractual rights for payment of the secured obligation or other performance. On the special problems of security rights, cf. Comment F below.

Contrary to many legal systems, the last sentence of paragraph (1) allows a cumulation of the right to reimbursement and the rights acquired by subrogation. Cumulation is useful in order to enable the security provider to obtain full recovery.

C. Debtor's exceptions

The debtor may invoke as against the security provider two sets of defences. First, the debtor can invoke those which the debtor was entitled to invoke vis-à-vis the creditor. This follows from the fact that the security provider could have invoked such defences against the creditor and from the fact that the security provider's subrogation to the creditor's rights against the debtor means that the security provider takes over those rights such as they are. Secondly, the debtor may invoke defences deriving from the debtor's relationship with the security provider. For example, the security provider may have waived the right to reimbursement (cf. Comment D below).

However, the debtor will be precluded from raising a defence which the debtor has against the creditor if the debtor failed to communicate it to the security provider when requested for information about defences under IV.G.– 2:112 (Security provider's obligations before performance) paragraph (1) since this omission caused the damage.

D. Exclusion of rights

The security provider may, exceptionally, have assumed the security without the intention of claiming reimbursement from the debtor and may have accordingly waived the rights conferred by paragraph (1). This does not, however, necessarily also exclude recourse claims against other security providers under IV.G.–1:108 (Several security providers: internal recourse).

E. Part performance by security provider

A security provider who performs only in part is, of course, entitled only to a corresponding part of the rights mentioned in paragraph (1). In order to protect the creditor, the creditor's partial rights to which the security provider has not (yet) been subrogated, enjoy preference in case of the debtor's bankruptcy or upon execution by a third person, over those of the security provider (paragraph (2)). This is a general principle in order to protect the priority of an earlier holder of a right as against a holder who derives rights from the former.

F. Subrogation to security rights

If and in so far as the security provider has paid to the creditor, it is subrogated to the rights which the creditor holds against the debtor. Among these rights are the creditor's "dependent and independent personal and proprietary security rights", as paragraph (3) explicitly confirms. There is no reason why the creditor should retain these rights, which are either accessory or of such a nature that to allow the creditor to retain and exercise them would be to allow the creditor to be unjustifiably enriched. Interests of other persons are not endangered.

There will rarely be such interests of third parties; if there are, *e.g.* security rights in those security rights, they will, of course, be respected and enjoy priority over the rights of the subrogated security provider.

Subrogation to the creditor's personal or proprietary security rights presupposes that these are transferable. The debtor and third person security provider may have attempted to exclude transferability by a term in their contract. Since the security provider had acted in the debtor's or third person's interest, it would be inequitable if the latter were allowed to invoke such a term. Therefore, paragraph (3) expressly declares such terms to be ineffective to prevent the subrogation.

G. Reimbursement from incapable debtor

According to IV.G.–2:103 (Debtor's defences available to the security provider) paragraph (3), a security provider cannot invoke the lack of capacity of the debtor or the non-existence of the debtor legal entity if the relevant facts were known to the security provider when the security became effective. So the security provider may be bound to pay the creditor even although the debtor (or apparent debtor) has a defence against the creditor. Paragraph (4) makes it clear that the security provider's right to reimbursement from the debtor is in these circumstances limited to the extent of the debtor's enrichment. The enrichment here is not the performance of the secured obligation, because the debtor was not liable for that performance and gained nothing by the fact that it was made, but the enrichment which the debtor may have received by a performance made by the creditor, *e.g.* the amount of a loan received.

It will be remembered that "debtor" in the case of a legal entity which is not only incapable but is even non-existent means "apparent debtor" (IV.G.–1:101 (Definitions) paragraph (d)). A legal entity may be inexistent if its creation was affected by a grave defect which according to the applicable law prevented it from coming into existence.

H. Consumer as security provider

This Article remains applicable to a dependent security assumed by a consumer; however, the provision becomes mandatory (cf. IV.G.–4:102 (Applicable rules) paragraph (2)).

The application of this Article to any independent personal security is already assured by IV.G.–3:108 (Security provider's rights after performance). This provision requires that application to be subject to "appropriate adaptations". However, in the present context it is not necessary to search for such adaptations since a consumer purporting to assume an independent personal security is according to IV.G.–4:105 (Nature of security provider's liability) sub-paragraph (c) treated like a provider of a dependent personal security. Therefore, the Article fully applies in the same way as it applies to a consumer assuming a dependent personal security, cf. preceding Comment.

The application of this Article to a consumer's co-debtorship for security purposes may be defended on policy grounds if and in so far as that process does not involve an unequivocal disadvantage for the consumer as compared to the situation under the otherwise applicable rules on solidary debtors. This has to be examined for each part of the Article.

The first sentence of paragraph (1) corresponds, in effect, to III.–4:107 (Recourse between solidary debtors) paragraph (1) which gives a co-debtor who has performed more than the correct share a personal right of recourse. The correspondence is not absolute since in a true

co-debtorship each of the co-debtors, in their internal relationship, bears some portion of liability. By contrast, in the context of a co-debtorship for security purposes, in the end the “secured” co-debtor is fully liable, while the security co-debtor is not liable at all. Therefore, if the creditor had received full payment from the “secured” co-debtor, the latter cannot claim any reimbursement from the security co-debtor. Conversely, if the security co-debtor had fully paid the creditor, that co-debtor may demand full reimbursement from the “secured” co-debtor.

An equivalent of the subrogation rules of the present Article is to be found in III.–4:107 (Recourse between solidary debtors) paragraph (2), which provides for subrogatory recourse. This equivalence is subject to the comments made in the preceding paragraph about the difference between normal co-debtorship and co-debtorship for security purposes.

Paragraph (4) of the present Article has no equivalent in III.–4:107 (Recourse between solidary debtors). In the application of those general rules to the situation here addressed the question would be whether there was a co-debtor at all. In so far as paragraph (4) gives relief against an only apparent debtor it can only be of advantage to the consumer security provider.

In short, there is no policy reason for not applying the present Article to the consumer co-debtor for security purposes.

Mandatory rules. All the preceding rules are mandatory in favour of the consumer (IV.G.–4:102 (Applicable rules) paragraph (2)). And in the context of a consumer security provider’s co-debtorship for security purposes the term “debtor” as used in the Article refers to the debtor whose obligation is secured.

CHAPTER 3: INDEPENDENT PERSONAL SECURITY

IV.G.–3:101: Scope

(1) The independence of a security is not prejudiced by a mere general reference to an underlying obligation (including a personal security).

(2) The provisions of this Chapter also apply to standby letters of credit.

COMMENTS

A. General

Due to the independence of the independent personal security from any underlying obligation, the rules applying to them are much simpler and can be less numerous than the corresponding rules on the dependent personal security. The latter have to spell out the extent and limits of dependence upon the secured obligation and the technical devices by which that dependency is realized. That, obviously, is not necessary for independent personal security since this stands largely on its own feet.

B. Definition

The independence from any other agreement, especially an underlying contract between the creditor and the debtor, is laid down and specified in IV.G.–1:101 (Definitions) sub-paragraph (b). In particular it is irrelevant for the security provider's obligation whether the underlying obligation (such as a seller's obligation to deliver or a buyer's obligation to pay the price under a contract of sale or for services) is based on a valid contract or not, which terms it contains and the extent of the debtor's obligations. The same independence exists with respect to any contract by which the debtor instructs the security provider to assume the independent personal security. The UN Convention on Independent Guarantees of 1995 defines the "Independence of undertaking" in a similarly broad manner (art. 3).

On the other hand, the validity of the contract or other juridical act from which the security provider's undertaking itself arises is crucial for the security provider's obligation. Thus the security provider must have full capacity and the undertaking must have been created without any defects of consent which might give rise to a right of avoidance.

The independent character of an independent security must be expressly or impliedly agreed. This rule dovetails with IV.G.–2:101 (Presumption for dependent personal security) paragraph (1) which establishes a presumption for any security being a dependent security, unless the creditor shows that it was agreed otherwise. For letters of credit and stand-by letters of credit, UCP 500 (1993) art. 3 and 4 explicitly and broadly emphasize the independence of the "credit" from underlying contracts or the objects of those contracts, such as goods, services and other performances. More succinctly in the same sense is UN Convention on Independent Guaranties article 3.

C. General reference to underlying obligation innocuous

Paragraph (1) serves to specify the independent character of a security. Usually, an independent security refers to an underlying contract (*e.g.*, of sale or services) or another security (*e.g.*, a "confirming" security to the security given by the bank opening a letter of credit; or a "counter security" to the security issued by the security provider on the instruction of the issuer of the counter security) in order to specify the event upon the occurrence (or non-occurrence) of which performance of the security may be demanded by the creditor. Any such general reference to an underlying obligation does not affect the independent character of a security. The decisive point is that the security provider's obligation to perform is independent of the obligation of the principal as debtor of the underlying contract with the creditor.

D. Stand-by letters of credit

According to paragraph (2), Chapter 3 applies to stand-by letters of credit. This clarification appears to be useful since the name of this instrument does not reveal its legal character as security. However, the "stand-by" letter of credit at least hints to the security function which letters of credit may fulfil and which, originally for reasons of AMERICAN internal banking law, this kind of letter of credit does fulfil. This is confirmed by the fact that stand-by letters of credit are also covered by the UN Convention on Independent Guaranties and "Stand-by Letters of Credit" of 1995. Functionally, the same is true for the "genuine" letter of credit, as used in international contract practice, since it secures claims for payment arising from various types of contract; the fact that in practice the security obligation represented by the letter of credit assumes the role of the primary obligation of a means of payment does not detract from its legal function as a mere security. The idea of independence of the security

covers even cases where no preceding demand under the underlying contract has been made. Cf. also the preceding Comment.

E. Independent security of a consumer

According to IV.G.–4:105 (Nature of security provider’s liability) sub-paragraph (c), a consumer’s “agreement purporting to create an independent security is considered as creating a dependent security, provided the requirements of the latter are met.” For details, cf. the Comments on that provision.

IV.G.–3:102: Notification to debtor by security provider

(1) The security provider is required:

(a) to notify the debtor immediately if a demand for performance is received and to state whether or not, in the view of the security provider, performance falls to be made;

(b) to notify the debtor immediately if performance has been made in accordance with a demand; and

(c) to notify the debtor immediately if performance has been refused notwithstanding a demand and to state the reasons for the refusal.

(2) If the security provider fails to comply with the requirements in paragraph (1) the security provider’s rights against the debtor under IV.G.–3:109 (Security provider’s rights after performance) are reduced by the extent necessary to prevent loss to the debtor as a result of such failure.

COMMENTS

A. Introductory

This Article requires the security provider to notify the debtor if a demand for performance is received from the creditor or is met or is refused and sets out the sanction for failure to comply with the requirements.

B. Requirement of notification of receipt of demand

The first paragraph obliges the security provider to inform the debtor of any demand for performance received from the creditor. It may be expected that the security provider would also state whether or not the demand complies with the terms of the contract from which the security obligation arises. The information is to be given not only in order to keep the debtor informed about the creditor’s demand from which other consequences may ensue in the relationship between the debtor and the creditor. A more direct purpose of the information is to prevent the risk of double payment (by the debtor as well as the security provider) and to provoke the debtor to bring to the attention of the security provider any possible objections or doubts concerning the creditor’s full compliance with the terms of the contract or other juridical act creating the security. Also, the debtor may furnish objections which, exceptionally, may qualify the creditor’s demand as manifestly abusive under IV.G.–3:104 (Manifestly abusive or fraudulent demand).

C. Requirement of notification of performance or refusal of performance

A security provider who performs the obligation on demand is required to inform the debtor immediately. Again this serves to prevent double payment.

Also, if the security provider's examination of the creditor's demand leads to the conclusion that performance of the demand must be refused, the security provider should forthwith inform the debtor stating the reasons for refusal. This requirement serves the purpose of clarifying the situation for the security provider and the debtor so that they are enabled to consider and prepare any steps which may be appropriate. For instance, the debtor may confirm that the reasons for refusal are justified, or point out that they are not justified.

D. Consequences of failure to notify immediately

The consequences of a failure by the security provider to comply with the requirements in the Article are that the security provider's rights to reimbursement from the debtor are reduced by the extent necessary to prevent any loss to the debtor as a result of the security provider's omission or delay. If, for example, a failure to notify leads the debtor to pay the creditor again in such circumstances that the payment cannot be recovered, it would clearly prejudice the debtor if the security provider could still obtain reimbursement from the debtor. The debtor would then pay twice because of the security provider's failure to notify. In such a case the most appropriate way of avoiding loss to the debtor is to extinguish altogether the security provider's right to reimbursement

IV.G.–3:103: Performance by security provider

(1) The security provider is obliged to perform only if there is, in textual form, a demand for performance which complies exactly with the terms set out in the contract or other juridical act creating the security.

(2) Unless otherwise agreed, the security provider may invoke defences which the security provider has against the creditor.

(3) The security provider must without undue delay and at the latest within seven days of receipt, in textual form, of a demand for performance:

(a) perform in accordance with the demand; or

(b) inform the creditor of a refusal to perform, stating the reasons for the refusal.

COMMENTS

A. Introductory

This Article lays down the requirements for a demand for performance and most of the reasons which the security provider may invoke against such a demand and the procedures which must be observed in this respect. The security provider must examine the creditor's demand for performance or a demand to extend the security or pay. The security provider may raise personal objections and defences available against the creditor. The security provider must either perform promptly or notify the creditor promptly of a refusal to perform and will be liable in damages for non-performance.

B. Requirements for creditor's demand

The creditor's demand for performance must be in textual form. This requirement has been established for the sake of legal certainty and because of the high sums of money that are usually involved. The text must specify the contract of security to which it relates and the amount of money or the quantity and kind of other performance which is demanded. The expression "textual form" means "a text which is expressed in alphabetical or other

intelligible characters by means of any support which permits reading, recording of the information contained in the text and its reproduction in tangible form” (see I.–1:105 (Meaning of “in writing” and similar expressions)).

The creditor’s demand must comply with all the terms and conditions laid down in the contract or other juridical act creating the security. One may distinguish between simple and documented demands. A simple demand is one which merely contains a demand for payment of a definite sum of money or an equivalent act, without requiring further written support. By contrast, a so-called documentary demand is one where the demand for payment must be supported by documents, the type and contents of which must strictly comply with the requirements fixed by the security contract. The UCP 500 (1993) devote almost 20 elaborate provisions to general prescriptions concerning the minimum requirements as to form and substance of various types of documents which the beneficiary typically may have to present for a demand under a letter of credit (articles 20–38) and the ISP98 contain over 20 such provisions (rules 4.01–4.21).

C. Examination of creditor’s demand

It is implicit in this and the preceding Article that the security provider must examine the creditor’s demand for performance. In the interest of the debtor, the security provider should carefully investigate whether the creditor’s demand strictly satisfies all the terms and conditions of the security. Even if exceptionally the security provider was not instructed by another person, it is in the security provider’s own interest to undertake this examination in order to ensure that payment is not made without the conditions for payment having been fulfilled. The security provider must also check whether any objections may have to be raised with respect to the validity of the contract or other juridical act creating the security. Any failure to do this tends to endanger the security provider’s claim for recourse against the debtor.

The security provider’s examination of the demand must take place within a reasonable period of time. Both the UCP 500 (1993) (art. 13 lit. b) and the ISP98 (rule 5.01 (a) (i)) as well as the UN Convention on Independent Guarantees (art. 16 (2)) fix a maximum of seven business days for the reasonable period, unless the parties have agreed otherwise. This maximum appears to be sensible also for the present Article. (See paragraph (3).) Of course, the parties are free to fix a different time limit.

If the demand or any documents accompanying it do not fully comply with the terms of the contract or other juridical act creating the security, the security provider is, vis-à-vis the creditor, not obliged to perform. This rule implies that the security provider, in spite of doubts, may decide to perform. However, a security provider must also take care to perform any obligations owed to the debtor. If time permits, the security provider should also inform the creditor and ask the creditor to remedy any open point.

D. “Extend or pay”

Occasionally a creditor may set forth the alternative demand of “extend or pay”. This is to be understood as an offer to the security provider to extend the time limit for the guarantee or, if that offer is rejected, to perform the security. If the security provider accepts the requested extension of time, the demand for performance must be regarded as withdrawn. If the security provider does not accept the requested extension, the security provider must examine the

demand for performance according to the rules set out above at C. In the same sense ISP98 rule 3.09.

E. Security provider's personal objections and defences

Apart from objections and defences relating to the validity of the contract or other juridical act creating the security and as to full compliance with its terms, the security provider may also invoke objections and defences to which the security provider is personally entitled as against the creditor. This covers also the security provider's right to set-off a personal monetary claim against the creditor's claim under the security (cf. UN Convention on Independent Guarantees art. 18).

Usually, these objections and defences may be rooted in earlier and different legal relationships between the security provider and the creditor. Consequently, it would be irreconcilable with the independence of the security if the security provider could invoke an objection or defence arising from a claim which another person, especially the debtor, had assigned to the security provider. It is equally inadmissible for the security provider to set-off a right acquired by assignation from such a debtor. Invoking such defences or asserting such a set-off would run counter to the independent character of an independent security whose essence is the insulation from any underlying relationship between the creditor and a debtor.

The parties may expressly or impliedly exclude other personal objections as well. An exclusion may *e.g.* be implied if the security provider promises "unconditional" performance upon the creditor's demand.

F. Duty of information on refusal of performance

If the security provider's examination of the creditor's demand leads to the conclusion that performance of the demand must be refused, the security provider must inform the creditor, stating the reasons for refusal. This obligation to inform serves the purpose of clarifying the situation for the parties directly affected so that they are enabled to consider and prepare any steps which may be appropriate. For instance, the creditor, if time limits allow, may wish to remedy any defect in the demand pointed out by the security provider.

G. Remedies for security provider's non-performance

The creditor will have the usual remedies under Book III for non-performance of a security provider's obligations under this Article.

IV.G.-3:104: Independent personal security on first demand

(1) An independent personal security which is expressed as being due upon first demand or which is in such terms that this can unequivocally be inferred, is governed by the rules in the preceding Article, except as provided in the two following paragraphs.

(2) The security provider is obliged to perform only if the creditor's demand is supported by a declaration in textual form by the creditor which expressly confirms that any condition upon which performance of the security becomes due is fulfilled.

(3) Paragraph (2) of the preceding Article does not apply.

COMMENTS

A. The special feature of a first demand security

An independent personal security that falls due upon “first demand” enjoys a higher degree of independence than a simple independent security. Being more efficient than a simple independent security, it is also more risky to the security provider who therefore deserves a somewhat better protection. This Article provides for both these features (see Comments C and D).

B. Applicable rules

Since the independent security on “first demand” is a special type of independent security, the general rules on demand of a security, as laid down in the preceding Article apply to it, subject to the special rules in the present Article, paragraphs (2) and (3).

C. Restriction of security provider’s defences

As the name of the security “on first demand” indicates, it is the special feature of this particular kind of independent security that the creditor is entitled to a fast and effective satisfaction. Therefore, the security provider’s possible defences against liability must be restricted. The general reference to the preceding Article covers also the defences contained in that provision, cf. Comment B. In addition, paragraph (3) of the present provision excludes defences to which the security provider in a personal capacity is entitled as against the creditor, including set-off with any counter-claim which the security provider may have against the creditor.

On the other hand, the defence of a manifestly abusive demand under the following Article remains available to the security provider since this defence is not rooted in the person of the security provider but, to the contrary, in that of the creditor.

D. Conditions for creditor’s entitlement

As explained in Comment C, a security on first demand restricts the security provider’s exceptions against the demand to the very exceptional cases of a fraudulent or abusive demand by the creditor. By contrast, performance on first demand does not mean that the creditor is only required to present a mere demand. There can also be a first demand guarantee if the creditor is contractually obliged to present additional documents. Such documentary securities and letters of credit are very frequent in practice.

In order to curb abusive demands which not infrequently have been made under “first demand” securities, recent practice sometimes requires the creditor to confirm expressly that the conditions upon which the security becomes due, are fulfilled. Such an express confirmation must be given in textual form by the creditor. While it imposes no real burden upon an honest creditor, such a declaration may be at least a moral warning to a dishonest person, and it may assist in bringing claims or even criminal prosecutions against a fraudulent creditor. If this declaration is not produced by the creditor, the security provider need not perform. A merely tacit implication of such a confirmation upon the model of the UN Convention on Independent Guarantees of 1995 art. 15 (3) does not appear to provide an effective assurance against fraudulent or abusive demands of performance.

IV.G.–3:105: Manifestly abusive or fraudulent demand

- (1) A security provider is not obliged to comply with a demand for performance if it is proved by present evidence that the demand is manifestly abusive or fraudulent.*
- (2) If the requirements of the preceding paragraph are fulfilled, the debtor may prohibit:*
- (a) performance by the security provider; and*
 - (b) issuance or utilisation of a demand for performance by the creditor.*

COMMENTS

A. The issue

Any independent security is, due to its independence from any underlying contractual or other relationship between the creditor and the debtor, a risky undertaking both for the security provider and especially for the debtor. This risk is even higher in the case of a security on first demand. Experience in many countries has shown again and again that some creditors may call for performance by wrongfully asserting that the agreed conditions for a demand are fulfilled.

Such unjustified demands, if accepted and performed by the security provider, often place the debtor in a very difficult situation. The debtor may have to reimburse the security provider and then seek reimbursement from the creditor. The creditor's place of business, however, may be located in a distant country; enforcement of a judgment, whether obtained locally or abroad, may be subject to similar difficulties.

In order to protect debtors against extreme instances of such abuse, courts in many countries have evolved remedies against abusive or fraudulent demands for performance of independent securities. Evidence that either the creditor's assertion about the justification of the demand is wrong or that documents presented are falsified, can usually only be adduced by the debtor. Exceptionally, in these cases, the principle of the independence of the security is disregarded and the security provider is allowed to rely on the terms of the underlying contract between creditor and debtor.

In shaping any such remedies, a carefully defined balance must be struck between the interests of honest creditors and also security providers, who are interested in a smooth, speedy and reliable system of honouring independent securities, on the one hand; and the prevention of truly abusive or fraudulent demands by unscrupulous creditors, on the other hand. The Article is based upon the practice that has been developed by the courts of the major trading nations and which has been approved by the majority of writers. It in essence corresponds to UN Convention on Independent Guarantees of 1995 art. 19.

In the following, first the position of the security provider and then that of the debtor will be considered.

B. Security provider's position in relation to creditor

The basic rule is that the security provider has to comply with a demand for performance, provided this demand strictly complies with the formal and substantive conditions for an effective demand established by the parties and by the two preceding Articles. This Article

provides a strictly limited exception to that basic rule. The grounds why a demand for performance, although on its face complying with the conditions for a demand, may nevertheless be unfounded in substance, derive from the underlying relationship between the creditor and the debtor. Such a recourse to an underlying relationship to which the security provider is not a party, must, of course, be very exceptional; its conditions are therefore very narrowly circumscribed.

According to paragraph (1), two conditions must be fulfilled before the exception applies. First, in substance, there must be a manifest abuse or fraud; and secondly, procedurally, this must be proved by present evidence.

The strong terms “abuse” and “fraud” require that the non-compliance of the demand with the terms of the security must be unequivocal, obvious and commercially relevant for the debtor.

Illustration

A contract for the sale of 10 000 t coffee provides for “shipment: September”. The bill of lading is dated 29 September, whereas in reality shipment took place on 3 October. This is a clear case of fraud: There is a manifest non-performance of the obligation under the contract of sale since prices vary from month to month.

In order to prevent unwarranted allegations of manifest abuse or fraud, the security provider must be able to rely on “present evidence”. This will usually have to be furnished by the debtor who had instructed the security provider to issue the security. All types of evidence are admissible, especially documents and witnesses. A restriction to documents only, which is sometimes preferred, is difficult to justify; also, the borderline is sometimes doubtful, e.g. in the case of affidavits. The weighing of the evidence is a matter for the court which is bound by the relevant procedural rules of the law of the forum.

If after honouring the creditor’s demand it is found out that this demand had not been justified or was even “manifestly abusive or fraudulent”, the security provider is entitled to reclaim from the creditor (cf. IV.G.–3:106 (Security provider’s right to reclaim)).

C. Security provider’s position in relation to debtor

The security provider’s position vis-à-vis the debtor differs, of course, from that towards the creditor. Compliance with an obviously abusive demand might well be a non-performance of a contract with the debtor and might therefore expose the security provider to the debtor’s contractual remedies, especially a claim for damages. The debtor could set off this claim against the security provider’s claim for reimbursement of the money or other performance which the security provider had paid or furnished to the creditor. More directly, the security provider would lose any right to reimbursement from the debtor under IV.G.–3:109 (Security provider’s rights after performance).

On the other hand, the security provider is, in principle, obliged to perform the undertaking to the creditor. Refusing to do so by invoking the present Article will almost inevitably expose the security provider to a confrontation with the creditor; the latter often will not easily accept the security provider’s objection.

In order to escape from this dilemma, the security provider may be well advised to turn to the debtor and ask for clarification and instructions. Without the debtor’s assistance, the security

provider will hardly be able to adduce the necessary proof of the creditor's manifest abuse or fraud. In practice, however, often the debtor may be well aware of the true situation and press the security provider to refuse performance of the security. In such circumstances it may be the debtor who will not only be willing to support the security provider by supplying information and documents; but will also strongly urge the security provider not to honour the creditor's demand.

D. Debtor's preventive remedies

According to paragraph (2), if the requirements of paragraph (1) are fulfilled, the debtor is entitled to remedies both against the security provider and the creditor.

The remedy against the security provider is in line with the security provider's obligation towards the debtor to refrain from complying with the creditor's demand.

The debtor's remedy against the creditor is rooted in the direct relationship between these two parties and the manifestly abusive or fraudulent non-performance of that contract. This rule, in essence, corresponds to the UN Convention on Independent Guarantees of 1995 art. 20. The specific form of court remedies that are available or may be fashioned by the court, is left to the procedural law of the forum state and the discretion of the court. However, three specific remedies mentioned by UN Convention art. 20 paras. (1) and (2) should be mentioned here as means of achieving a balance between the contradictory interests of the creditor, on the one hand, and the security provider and/or the debtor, on the other hand:

- (1) the security provider may be ordered not to transfer the amount of the creditor's demand to the latter and to hold the amount of the security;
- (2) if payment has already been effected, the court may order that the creditor may not dispose of the proceeds;
- (3) the person applying for a court order may have to furnish security in a form to be determined by the court.

IV.G.–3:106: Security provider's right to reclaim

- (1) *The security provider has the right to reclaim the benefits received by the creditor if:*
 - (a) *the conditions for the creditor's demand were not or subsequently ceased to be fulfilled; or*
 - (b) *the creditor's demand was manifestly abusive or fraudulent.*
- (2) *The security provider's right to reclaim benefits is subject to the rules in Book VII (Unjustified Enrichment).*

COMMENTS

A. The issue

In the factually triangular situation of an independent security it is not quite clear who is entitled to request return of a performance that had been made by the security provider on the creditor's demand, although the conditions for the demand had not been fulfilled or later disappeared or the demand was abusive or fraudulent. Is the security provider entitled or rather the debtor or both?

National legal systems vary considerably on this issue, using sometimes very fine distinctions in allocating the right to the one or the other party. However, in this field any such distinction does not appear to be practicable since it leaves a margin of uncertainty. Therefore, only the *alternative* between security provider and debtor offers clarity and certainty.

Doubts may arise due to the fact that the security provider's performance of the creditor's demand at the same time often will extinguish (or reduce) an obligation of the debtor vis-à-vis the creditor in the framework of an underlying relationship between these two parties. This fact is sometimes invoked as justifying that return of such performances can only be requested by the debtor. However, this thesis overlooks the fact that the security provider's obligation is a separate and independent obligation and usually its content will also differ from the debtor's obligation to the creditor. The security provider only performs the security obligation; usually, of course, such performance may also extinguish (or reduce) the debtor's obligations towards the creditor, but this effect is incidental.

The better reasons speak for entitling the security provider. The person who performed has the greatest interest in rectifying an unjustified performance. Also, the security provider is more familiar with the circumstances under which performance was made and with defences and objections against the creditor's claim which the security provider had been precluded from raising against the creditor. This solution also avoids the duplication of remedies which would be involved in giving the debtor a right to reclaim from the creditor and then giving the security provider a right to claim from the debtor. Not only would this be inefficient but it would also expose the security provider to risk if the debtor has become bankrupt.

However, the security provider often will require the debtor's assistance with respect to the facts or legal rules envisaged by the terms regulating the independent security for justifying the creditor's demand. Such assistance is even more important if the conditions for the creditor's demand under the independent security had originally been fulfilled but later disappeared.

If the parties feel that it is more convenient to let the debtor bring the claim or an action against the creditor, they are free to agree on an assignment of the security provider's rights to the debtor.

However, there is an important outer limit to the security provider's entitlement. This follows from the wording of paragraph (1). The security provider may only invoke the terms of the independent security as against the creditor. By contrast, the security provider is not entitled to invoke the terms of an underlying contract or other juridical act between the debtor and the creditor. If the security provider's promise of performance had been invoked and honoured although the debtor had performed the secured obligation to the creditor in circumstances where performance was not due, any claim for the return of what was conferred by this performance must be brought by the debtor against the creditor. The only exception to this limitation is the case of an evidently abusive or fraudulent demand; but this exception is to be very strictly construed.

B. Terms of demand not fulfilled

Upon receiving a demand for performance, the security provider must examine the validity of the independent security and whether the demand exactly complies with the terms and

conditions of the independent security; the debtor must be informed of the demand (cf. IV.G.–3:102 (Notification to debtor by security provider). Nevertheless, due to a misunderstanding or due to temporary absence of a competent person in either the security provider’s or the debtor’s office it may occur that the security provider erroneously believes that performance is due on the creditor’s demand and in fact performs. The security provider is then entitled to demand return of the benefits conferred by the performance.

Illustration 1

B in France has concluded with S in England a contract of sale for 500 English sheep. On S’s demand, B requests X-Bank in London to assume an independent security for payment of the purchase price which may be utilised by S on the day of shipping the sheep to France and on presentation of a veterinary certificate for the sheep. Although S has not presented such a certificate because he did not apply for it, he demands payment. An employee at X-Bank overlooks the absence of the required certificate and therefore honours S’s demand for payment. X-Bank may request repayment of the amount paid under the independent security from S.

C. Security provider’s defence or counterclaim

The security provider may have a defence or a counterclaim against the creditor which the security provider was not permitted to raise or to set off under the terms of the independent security or under an independent security on first demand. After having performed the security, the security provider is entitled to request return of the performance made on the basis of those defences or to raise the counter-claim.

D. Terms of demand subsequently disappeared

The justification for a demand that existed at the time of presentation of the security may later have disappeared.

Illustration 2

The basic facts are as in Illustration 1. However, S has applied for and obtained such a certificate, and X-Bank duly makes payment to him. Thereafter, the veterinary certificate is revoked due to the BSE crisis in England.

For the reasons set out in Comment A, the security provider should also in this case be entitled to request return of the money paid.

It deserves to be mentioned that the provider of an independent security is entitled to demand return of the benefits conferred by performance only if the conditions of the independent security had not been fulfilled or had later fallen away. If performance of the independent security for reasons rooted only in the underlying relationship never was justified or subsequently is no longer justified, then only the debtor as a party to that contract is entitled to request “return” of the performance.

Illustration 3

As in Illustration 2, but it turns out that the sheep are infected and therefore the French customs authorities refuse entry of the sheep to France. B terminates the contractual relationship. Only B and not X-Bank may request repayment of the purchase price from S.

E. Manifestly abusive or fraudulent demand

If the provider of independent security for whatever reason performs a demand which is, and is proved by present evidence to be, manifestly abusive or fraudulent, the security provider is entitled to request return of the performance made. The reasons correspond to those mentioned in Comment A.

However, if the security provider has already been (or may in future be) reimbursed by the debtor for the performance to the creditor, it may be more convenient for the parties to have the claim for repayment brought by the debtor; the security provider may then simply assign the right against the creditor to the debtor.

F. Consequences governed by rules on unjustified enrichment

The conditions set out in the first paragraph of the Article closely correspond to the basic conditions of a claim for unjustified enrichment. It is therefore consistent to refer with respect to the details of the provider's claim for return of the performance to those rules, as set out in Book VII.

In particular, the rules on unjustified enrichment may preclude a security provider's claim for return if the security provider knew (or ought to have known) at the time of the creditor's demand that this demand did not comply with the terms and conditions of the independent security or that the demand was manifestly abusive or fraudulent, if and in so far as the security provider had been entitled to raise those defences.

IV.G.–3:107: Security with or without time limits

(1) If a time limit has been agreed, directly or indirectly, for the resort to a security, the security provider exceptionally remains liable even after expiration of the time limit, provided the creditor had demanded performance according to IV.G.–3:103 (Performance by security provider) paragraph (1) or IV.G.–3:104 (Independent personal security on first demand) at a time when the creditor was entitled to do so and before expiration of the time limit for the security. IV.G.–2:108 (Time limit for resort to security) paragraph (3) applies with appropriate adaptations. The security provider's maximum liability is restricted to the amount which the creditor could have demanded as of the date when the time limit expired.

(2) Where a security does not have an agreed time limit, the security provider may set such a time limit by giving notice of at least three months to the other party. The security provider's liability is restricted to the amount which the creditor could have demanded as of the date set by the security provider. The preceding sentences do not apply if the security is given for specific purposes.

COMMENTS

A. General

Basic idea. Within this Part, it is intended that dependent and independent personal securities should follow substantially identical rules as regards the question of agreed time limits and their legal consequences. This approach is in line with the position under international regulations, which at least in relation to matters of time limits for resort to a security subject independent securities to rules similar to the one contained in IV.G.–2:108 (Time limit for

resort to security) for dependent securities (cf. UCP 500 (1993) art. 42, UN Convention on Independent Guarantees of 1995 art. 11 (1) (d) read with art. 12 (a)).

Content of the rule. Paragraph (1) covers independent securities with an agreed time limit for resort to security, while paragraph (2) deals with the possibility of the security provider limiting liability in cases where the security is given without a time limit. In both paragraphs the rules are drafted in a way closely resembling the provisions of IV.G.–2:108 (Time limit for resort to security) and IV.G.–2:109 (Limiting security without time limit) respectively. However, minor differences stem from the independent nature of the personal securities covered by this Chapter.

B. Security with time limit for resort to security

Scope. An independent security can be subject to different types of time limits. Some time limits relate to the point of time at which the conditions for liability under the security, if any, must be fulfilled. A time limit for resort to security as covered by paragraph (1), however, exists where the parties have agreed that the security provider ceases to be liable after a certain point of time. This will typically be the case where the parties have used formulas such as “This security expires August 31” or “The security provider is liable under this security only until August 31”.

Consequences of expiration of time limit. As follows indirectly from paragraph (1) sentence 1 (“the security provider exceptionally remains liable”), the general rule is that the security provider is no longer liable at all towards the creditor after expiration of the agreed time limit. The security provider remains liable after expiration of the agreed time limit only if the creditor had demanded performance at the proper time and in the required manner.

Time for demand for performance. Obviously, the demand for performance can have the effect of continuing the security provider’s liability only if it is made before expiration of the agreed time limit. Moreover, for reasons equivalent to those described in the Comments to IV.G.–2:108 (Time limit for resort to security), the creditor generally must be entitled to performance at the time of the demand, *i.e.* the additional conditions for liability under the security, if any, must be fulfilled. In situations where these conditions are fulfilled only close to expiration of the agreed time limit, this rule could cause difficulties for the creditor; in order to solve this problem, paragraph (3) of IV.G.–2:108 (Time limit for resort to security) is declared applicable with appropriate adaptations. Thus, where the aforementioned conditions (replacing in the context of independent securities the maturity of the secured obligations as referred to in the text of IV.G.–2:108 (Time limit for resort to security) paragraph (3)) are fulfilled at the moment of, or within fourteen days before, expiration of the time limit of the security, the demand for performance under the security may be made earlier than otherwise possible, but no more than fourteen days before expiration of the time limit.

Security provider’s maximum liability. Even if a demand for performance is made in accordance with the preceding requirements, the security provider’s maximum liability is limited to the amount which the creditor could have demanded under the security as of the date when the time limit expired. Subsequent developments cannot increase the security provider’s liability; from the agreed time limit itself also follows that the security provider is liable only if and in so far as the conditions for liability under the security are fulfilled by that time.

C. Security without time limit

Scope. Paragraph (2) covers securities that do not have any time limit, *i.e.* neither a time limit for resort to security as covered by paragraph (1) nor any other kind of restriction according to which the liability of the security provider effectively depends upon certain conditions being fulfilled before a certain time. Whether or not a security does have such a time limit, is a matter of construction of the parties' agreement; some general guidelines for interpretation might be found in the Comments to Article IV.G.–2:108 (Time limit for resort to security).

Possibility to set time limit. According to paragraph (2) sentence 1, the provider of an independent security without a time limit may set such a limit by simple declaration with a notice period of at least three months. For the rationale behind this minimum period of notice, cf. Comments to IV.G.–2:109 (Limiting security without time limit).

Effect of limitation. If the security provider sets a time limit according to paragraph (2), the security provider's liability after expiration of this time limit is restricted to the amount which could have been demanded by the creditor at that point of time. In the exceptional case of a non-monetary obligation of the security provider under the security, the extent of that obligation at the moment of expiration of the time limit set by the security provider is decisive. In any case, the security provider is only liable if and in so far as any conditions for liability under the security are fulfilled when the time limit expires. The limitation by the security provider does not, however, give rise to a time limit for resort to the security.

Exceptions. Paragraph (2) does not apply if the security is given for specific purposes. As with IV.G.–2:109 (Limiting security without time limit) the possibility of limiting a security under this Article is therefore of importance predominantly in situations where the security is assumed in order to secure the creditor against risks that are not exactly specified, resembling a global security, *e.g.* where the security provider undertakes to secure the payment of all demands that the creditor may make against the debtor arising from their business relationship. As under IV.G.–2:109 (Limiting security without time limit), no recourse to the general principle in III.–1:109 (Variation or termination by notice) paragraph (2) is possible where the special exception in paragraph (2) sentence 3 of the present Article applies.

IV.G.–3:108: Transfer of security right

(1) The creditor's right to performance by the security provider can be assigned or otherwise transferred.

(2) However, in the case of an independent personal security on first demand, the right to performance cannot be assigned or otherwise transferred and the demand for performance can be made only by the original creditor, unless the security provides otherwise. This does not prevent transfer of the proceeds of the security.

COMMENTS

A. The issues

One must distinguish between two closely related issues, *i.e.* the transfer of the proceeds of a security, on the one hand, and the transfer by contractual assignment or otherwise of the creditor's right to performance, on the other hand.

B. Transferability of proceeds

The transferability of the proceeds which result from the performance of the independent security upon the creditor's demand is everywhere affirmed (cf. UN Convention on Independent Guarantees of 1995 art. 10). This is in line with the principle of free disposition. On this, therefore, no rule is needed.

C. Transferability of the right to performance

The present Article deals only with the second issue which in part is quite controversial and therefore requires regulation.

Many international instruments prohibit transfer of the creditor's right to demand performance, unless otherwise agreed by the parties (UN Convention on Independent Guarantees of 1995 art. 9; UCP 500 (1993) art. 48; ICC Rules for Demand Guarantees art. 4; ISP98 rule 6.01 lit. a.). The reason for this deviation from the general principle that one can freely dispose of rights is the fear that a new creditor as transferee of an independent security may abuse the right. However, as a general assumption that fear appears to be unfounded. Paragraph (1) of the present Article therefore allows assignability as a general rule. It reaffirms for this context the general rule on assignability in III.-5:105 (Assignability: general rule). The paragraph also allows transferability – e.g. on death or bankruptcy).

The more risky type of independent security, the security on first demand, is declared to be non-transferable by paragraph (2) of the present Article. This exception is justified by the fact that an independent security on first demand is a rather risky instrument because the security provider may not even invoke its personal defences and exceptions (cf. Article 3:103 (3)). Paragraph (2) therefore seeks to strike an adequate balance between the general principle that, as a rule, a holder of a right can freely dispose of it, on the one hand, and means of defence against potential risks of abuse, on the other hand. However, the parties may deviate from this rule and allow assignment (see IV.G.-1:103 (Freedom of contract)).

D. Straight and qualified demands for performance

Finally, in cases covered by paragraph (1), it is necessary to distinguish between straight and qualified demands for performance. A straight demand is one where the creditor merely needs to put forward its demand, without additional declarations or documents. The assignment of a right which can be exercised in this way is risky since the assignee merely has to submit the agreed demand for performance. In these cases the debtor and the security provider may wish to protect themselves against abuse of the security by an unknown third person by excluding assignability of the security right.

The risks of a straight demand for security are avoided or, at least, considerably mitigated, if the independent security is qualified beyond a simple demand for performance. This is achieved if the parties agree that the demand as such must be accompanied by additional documents or declarations which would show that the substantive conditions for invoking the demand are present. The creditor as the direct partner of the debtor in the underlying transaction would be best qualified to produce the required documents; by contrast, an assignee will usually be a stranger to the underlying transaction. The optimal way out of this dilemma is for the assignee and assignor to co-operate and arrange for the latter to furnish in case of need the documents which according to the terms of the security must be produced. In

other words, this problem cannot be solved by a general rule, but must be left to a suitable agreement between the assignee and the assignor.

IV.G.–3:109: Security provider’s rights after performance

IV.G.–2:113 (Security provider’s rights after performance) applies with appropriate adaptations to the rights which the security provider may exercise after performance.

COMMENTS

A. General

Chapter 3 does not establish explicit rules on the rights which the provider of an independent personal security may exercise after having performed on the creditor’s demand. Instead, the present Article refers to IV.G.–2:113 (Security provider’s rights after performance) which deals with the rights which the provider of a dependent personal security may exercise after performance to the creditor. However, in view of the differences between dependent and independent securities, the rules of IV.G.–2:113 are to apply only “with appropriate adaptations”.

The general justification for this rather novel approach is that the true differences between dependent and independent personal securities reside in the prerequisites for demanding performance from the security provider. However, after the security provider has performed to the creditor, the security provider’s position towards the debtor and towards other security providers is very akin to that of the provider of a dependent security. In order to simplify and to achieve internal consistency it is appropriate to apply essentially the same rules to the after-performance stage of both instruments of personal security.

B. Security provider’s claim for reimbursement

The first sentence of IV.G.–2:113 paragraph (1) lays down the security provider’s right to be reimbursed by the debtor. Obviously, the same right pertains to the provider of independent security who had assumed on the debtor’s instruction the security and has performed it.

Exceptionally the security provider may have waived the right to reimbursement; then, of course, there is no recourse against the debtor, cf. Comment D on IV.G.–2:113.

Another equally peculiar and rare situation is present if the debtor is incapable or, as a purported legal entity, in truth non-existent, cf. Comment G on IV.G.–2:113.

The debtor may be able to set off counterclaims against the claim of the provider of an independent security for reimbursement.

In addition, cf. Comments B to D to IV.G.–2:113.

C. Subrogation to the creditor’s rights against the debtor

In order to strengthen the position of the provider of a dependent security, the second sentence of IV.G.–2:113 paragraph (1) subrogates the provider of a dependent security to the creditor’s rights against the debtor. In conformity with the laws of some member states, this subrogation is extended by the present Article to the provider of an independent security.

Of course, this subrogation is subject to the same exclusions that affected the creditor’s original rights against the debtor. On exclusions, cf. Comment D on IV.G.–2:113.

See also the following Comment.

D. Subrogation to the creditor’s personal and proprietary security rights

The security provider’s subrogation to the creditor’s rights against the debtor also extends to the personal and proprietary security rights which the creditor holds against the debtor or a third person. This subrogation comprises both the “dependent and independent personal and proprietary security rights”, as IV.G.–2:113 paragraph (3) expressly confirms. On the justification for not limiting this rule to dependent security rights, but extending it to independent security rights and further details, cf. Comment F to IV.G.–2:113. The present Article has the specific effect of extending such subrogation to providers of an independent security.

E. Creditor’s priority in case of part performance

The rule laid down in IV.G.–2:113 paragraph (2) applies with appropriate adaptations also to the case of partial performance of an independent security. Cf. Comment E on IV.G.–2:113.

CHAPTER 4: SPECIAL RULES FOR PERSONAL SECURITY OF CONSUMERS

IV.G.–4:101: Scope of application

(1) Subject to paragraph (2), this Chapter applies when a security is provided by a consumer.

(2) This Chapter is not applicable if:

(a) the creditor is also a consumer; or

(b) the consumer security provider is able to exercise substantial influence upon the debtor where the debtor is not a natural person.

COMMENTS

A. General

This Article delimits the personal scope of application of the special rules established in Chapter 4 for the protection of consumer providers of personal security.

The key term “consumer” is defined in Annex 1 and need not therefore be explained here.

B. Assumption of personal security

The assumption of a personal security by the security provider usually – except in certain commercial relations – merely contains obligations of the security provider in favour of the creditor; the latter's acceptance of the terms offered by the security provider often is not explicit and therefore requires special regulation, cf. IV.G.– 1:104 (Creditor's acceptance). As far as the contents of the security contract is concerned, this is governed by the general principle of freedom of contract (IV.G.– 1:103 (Freedom of contract)). Such freedom, however, is strongly limited by the rules in this Chapter for security obligations assumed by consumers.

C. Restrictions of the personal scope of application

Paragraph (2) of the Article restricts the application of Chapter 4 in two ways: the Chapter does not apply if either the creditor is also a consumer; or if the security provider can exercise substantial influence upon the debtor, provided the latter is not a natural person.

The creditor is also a consumer. If not only the security provider, but also the creditor is a consumer, typically there is no necessity of protecting the security provider. The creditor as consumer typically is on the same level of sophistication as the security provider; usually both are weak parties. Therefore, the ordinary contract rules should apply.

It would be inadequate to require a typical consumer in the position of the creditor to comply with the special rules of care, duties of information and formality established by IV.G.–4:103 and 4:105. Due to ignorance of these requirements, many otherwise impeccable contracts of personal security would be void or at least avoidable by the security provider. That risk is unacceptable.

Of course, sometimes the creditor, although a consumer, may be more shrewd than the security provider and may therefore “drive a hard bargain” by imposing inequitable terms on the security provider. In such cases, the security provider may invoke the general protective rules on unfair contract terms in Book II, Chapter 9, Section 4.

The consumer security provider with substantial influence upon the debtor who is not a natural person. The exclusion in paragraph (2)(b) is inspired by legislation and court practice in some member states. Natural persons who are closely affiliated – whether by legal bonds or by factual influence – with a company, whether or not a legal entity, do not deserve the normal protection afforded to a consumer. Of course, in many cases such persons, in providing a personal security for company obligations, are acting in a commercial capacity, *e.g.* as managers or directors of a company which has taken credit. However, in practice sometimes major non-commercial shareholders of such a company assume a personal security for financial obligations of the company.

Paragraph (2)(b) uses the terms “able to exercise”. It is not required that the person has in fact exercised substantial influence since it would be difficult for an outsider to determine and prove the exercise of such influence in the case at hand. What is decisive is the ability of the security provider to exercise such influence. This ability may rest upon legal grounds, *e.g.* as a holder of the majority of the shares. But it may also be based upon factual circumstances, *e.g.* as the younger and energetic wife of a majority shareholder. Obviously, this is a factual issue which has to be decided in the light of all the relevant facts.

On the application of the provision to a case of co-debtorship for security purposes, see Comments on IV.G.–1:106 (Co-debtorship for security purposes).

D. Mandatory provision

This Article is a mandatory provision in favour of the consumer security provider. See paragraph (2) of the following Article.

IV.G.–4:102: Applicable rules

(1) A personal security subject to this Chapter is governed by the rules of Chapters 1 and 2, except as otherwise provided in this Chapter.

(2) The parties may not, to the detriment of a security provider, exclude the application of the rules of this Chapter or derogate from or vary their effects.

COMMENTS

A. Introduction

Paragraph (1) provides that the general rules of Chapters 1 and 2 apply to personal security provided by consumers, subject to the provisions of the present Chapter, while paragraph (2) fixes and specifies the mandatory character of the applicable rules.

B. Applicable rules

The applicability of Chapter 1 means that the general rules on personal security contained in that Chapter also apply – subject to any special rules established in Chapter 4 – to personal security assumed by a consumer.

In particular, the present Chapter also applies to a co-debtorship for security purposes. If one of the co-debtors is a consumer, the present Chapter 4 is applicable to that security provider; this is already spelt out in IV.G.–1:106 (Co-debtorship for security purposes). In addition to the present Chapter – and subject to its special provisions – also the regime for the protection of the security provider in Chapter 2 applies to a consumer’s co-debtorship for security purposes by virtue of the reference to that Chapter which is contained in paragraph (1). The application of Chapter 2 is justified by the fact that the rules on dependent security make it the mildest form of security; and this is reinforced by the fact that, when applied to a consumer, those rules may not be derogated from to the disadvantage of the consumer, cf. paragraph (2) of the present Article. By contrast, a general co-debtorship without security purpose is only subject to Book III, Chapter 4, Section 1.

Also the set of rules on the rights and obligations of several security providers (IV.G.– 1:107–1:109) apply to consumer security providers.

The applicability of Chapter 2 means that the general rules on dependent personal security also apply to personal security assumed by consumers. Since Chapter 3 on independent personal security is *not* mentioned in paragraph (2), personal security by consumers can only be granted as a dependent personal security. This conclusion is explicitly confirmed by IV.G.–4:105 (Nature of security provider’s liability) sub-paragraph (c).

While, generally speaking, Chapter 2 applies to a consumer's personal security, that general principle is subject to many exceptions. In fact, all the substantive rules of Chapter 4 derogate from, or supplement, the rules of Chapter 2 on dependent personal security. These supplements and derogations will be set out and explained in the Comments to the relevant rules.

C. Mandatory character of Chapter 4

As is usual for provisions serving the protection of consumers (or other weak parties), paragraph (2) provides that the parties to a personal security may not deviate to the disadvantage of a consumer security provider from the rules of this Part.

It is to be noted first, that this prohibition covers not only Chapter 4, but all the rules on personal security in this Part. Only by extending the protection of the consumer security provider beyond Chapter 4 to all the other Chapters is full protection assured. Also the negative implication of paragraph (1), namely the non-access of consumers to furnishing independent personal security is covered.

The consumer provider of personal security is protected against any deviation "to the disadvantage of a consumer security provider" from the rules of this Part. Deviations that are favourable for the consumer security provider are allowed. It is impossible to give an abstract definition of a disadvantageous deviation and neither is it possible to give a complete catalogue. Two general criteria must in each case be fulfilled. First, the specific instrument or contract or term must deviate from the specific rules in Chapters 1 to 4. And secondly, this deviation must be to the disadvantage of the consumer security provider. Out of dozens of possibly disadvantageous deviations, two specific cases may be offered for purposes of Illustration:

Illustration 1

According to a very frequently used term the creditor maintains all rights against the security provider until the debtor of the secured obligation has completely performed any outstanding obligation. This term deviates in case of partial repayment of the credit from IV.G.-2:102 (Dependence of security provider's obligation) paragraph (1) and is therefore void.

Illustration 2

Another term used in practice provides that the security provider remains liable, even if the creditor, for whatever reasons, fails to exercise all available rights against the debtor or another security provider. This term deviates from IV.G.-2:110 and is therefore void.

Each disadvantageous deviation as such is relevant. It is not possible to "compensate" one negative deviation by another positive deviation in favour of a consumer, since it would be difficult, if not impossible to attach relative weights to the one and the other factor.

The consequence of any disadvantageous deviation from the rules of this Part is not spelt out expressly. However, the clear implication of paragraph (2) is that a prohibited deviation is void. This nullity primarily affects the prohibited term of the contract. In general, the remaining part of the contract continues in effect; however, if the balance of the remaining

rights and obligations of the parties would be fundamentally affected in favour of one of the parties and it would be unreasonable to uphold the remaining part of the contract, then the entire contract may become void. See II.-1:109 (Partial invalidity). An abstract formula for the decision whether or not to uphold the remaining part of the contract cannot be offered. Obviously, everything depends upon the circumstances, such as the importance of the prohibited term and the extent and weight of the remaining rights and obligations of the parties to the contract.

IV.G.-4:103: Creditor's pre-contractual duties

(1) Before a security is granted, the creditor has a duty to explain to the intending security provider:

(a) the general effect of the intended security; and

(b) the special risks to which the security provider may according to the information accessible to the creditor be exposed in view of the financial situation of the debtor.

(2) If the creditor knows or has reason to know that due to a relationship of trust and confidence between the debtor and the security provider there is a significant risk that the security provider is not acting freely or with adequate information, the creditor has a duty to ascertain that the security provider has received independent advice.

(3) If the information or independent advice required by the preceding paragraphs is not given at least five days before the security provider signs the offer of security or the contract creating the security, the offer can be revoked or the contract avoided by the security provider within a reasonable time after receipt of the information or the independent advice. For this purpose five days is regarded as a reasonable time unless the circumstances suggest otherwise.

(4) If contrary to paragraph (1) or (2) no information or independent advice is given, the offer can be revoked or the contract avoided by the security provider at any time.

(5) If the security provider revokes the offer or avoids the contract according to the preceding paragraphs, the return of benefits received by the parties is governed by Book VII (Unjustified Enrichment).

COMMENTS

A. Need for protection

In view of the risk which any security provider incurs by assuming a personal security of whatever kind, the interest in self-protection should inspire the security provider to obtain as much information as possible from the debtor about the debtor's economic situation. Private persons and even more so business partners often know or at least often will or should be able to find out such information.

Experience in virtually all member states shows, however, that there are many private individuals who either close their eyes to the potential risks or who are unable to obtain relevant information. A few legislators and courts in some countries have obliged the creditor in certain circumstances to reveal to the intending security provider the debtor's financial situation. This should make the security provider aware of the risk which may be incurred by

assuming the personal security. This, again, is a protective rule for consumer security providers, especially close relatives of the debtor who often are ignorant of, or blind to, the debtor's economic situation because they are moved by the desire to help and sentiments of kinship and benevolence. It is therefore necessary to establish specific rules aiming at protecting the security provider by making additional information available so that the security provider can better evaluate the risk incurred by assuming a personal security.

Such assistance is the more necessary since relatives or friends of a private debtor (who very often also is a consumer) usually assume a personal security without remuneration. In effect, they "donate" their credit and risk losing major portions of, or even all, their assets.

B. Information and advice for the security provider

Creditor's information. Paragraph (1) specifies the information that has to be disclosed by the creditor to the security provider.

Paragraph (1)(a) does not deal with the subjective risks inherent in the debtor, but with the general objective legal and economic risks that are connected with a dependent personal security. The creditor must start from the assumption that consumer security providers are not familiar with the far-reaching effects of assuming any personal security. In particular, intending security providers must be made aware that they will assume a potential debt for which they may be liable with all their assets. The practical effects of this abstract rule must clearly be impressed upon the mind of the intending security provider. This must be done in such a way that the latter becomes clearly and fully aware of the very real risk incurred by assuming the personal security.

Paragraph (1)(b) deals with the special personal risks which are inherent in the financial position of the debtor. Professional creditors usually will be able, either on the basis of earlier dealings with the debtor or else by virtue of investigations, to evaluate the economic capacity of their debtor. All presently available information on the economic potential of the debtor, especially present assets (whether encumbered or not) and earning capacity, must be utilised. These data are already relevant for the creditor's decision whether or not to grant a credit to the debtor. On this basis the creditor can and must provide a complete picture of the financial situation of the debtor to the intending security provider.

In the case of middle-term or even long-term credits, the investigations of the debtor and consequently the information given to the intending security provider must be even more extensive and careful. Of course, nobody is expected to make prophecies. However, those potential developments which can relatively clearly be foreshadowed must also be disclosed. This refers to data like the age and health situation of the debtor and consequences which these may have for the debtor's future economic situation.

The creditor's duty of disclosure is qualified by the words "information accessible to the creditor". The qualifying term "accessible" must be understood subjectively as meaning all the relevant information about the debtor of which the creditor disposes at the time of contracting the security. According to the drafting history accessibility does not prejudice the issue whether the relevant information must also be accessible to the security provider. If the creditor due to binding rules of professional secrecy, especially bank secrecy, is prevented from divulging all relevant information to which the creditor has access to the security provider, the creditor must attempt to obtain the debtor's consent for passing the information

to the security provider or must bear the consequences of this subjective inability which are spelt out in paragraphs (3) –(5). Such a disability must be disclosed to the intending security provider so that he or she can look for other sources or for independent advice. An omission of such a disclosure may expose the creditor to the obligation to compensate any damage caused to the security provider.

Independent advice. Paragraph (2) deals with a special situation in which the creditor has a duty to ascertain that the intending security provider receives *independent* advice from a third person.

Such recourse to a source of independent advice is required if the creditor “knows or has reason to know” that the security provider “is not acting freely or with adequate information” in assuming the security. If the creditor’s knowledge is alleged, this will require adequate proof. If it is alleged that the creditor had “reason to know”, the interested party must prove the knowledge by the creditor of such facts as will allow the inference to be drawn that the creditor ought to have known of a relationship of trust and confidence between the debtor and the security provider.

A relationship of trust and confidence between security provider and debtor as such does not meet the requirement of paragraph (2). There are millions of such relationships, especially in well-functioning families. The members of such a family may have acquired or preserved personal independence and experience with respect to financial matters, especially by the independent administration of their financial affairs. However, there are probably more families where not all members have experience of this kind to a significant extent. Children, even if they have reached the age of majority, do not always appreciate financial risks of greater dimension. The same may also be true of sick or old people, depending upon the individual circumstances. If both the security provider and the debtor are members of a relationship of the latter type, then there is obviously a significant risk that the security provider is not acting freely or is acting without adequate information.

If the requirements mentioned in the preceding two paragraphs are fulfilled, then the creditor must ascertain that the security provider has received “independent advice” with respect to the assumption of the security required by the creditor. In practice this means that the creditor must request the intending security provider to obtain advice from an independent third party. The creditor’s legal advisor obviously would not qualify for this purpose. Independent advice may be rendered by consumer organisations or bodies providing legal assistance. In important or complicated cases, advice by independent lawyers may be necessary. The costs will have to be borne by the security provider or the debtor.

C. Sanctions

Paragraphs (3) to (5) provide the sanctions if the information required by paragraph (1) or the independent advice required by paragraph (2) have been furnished late or have not been furnished at all. In these circumstances the consumer security provider is regarded as having assumed the security improvidently. These sanctions apply whether or not the consumer security provider in fact suffered a disadvantage.

Paragraphs (3) and (4) deal with two different, although related fact patterns: paragraph (3) applies if the information or independent advice is given, but is not given within the required

time limit; by contrast, paragraph (4) applies if no information or independent advice at all is furnished.

According to paragraph (3) the information or independent advice required by paragraphs (1) and (2) must be furnished to the security provider “at least five days” before signing the offer of security or the contract creating the security. Five days should suffice to review the required information or independent advice; in the case of contracts for larger amounts, usually negotiations take more time so that in fact a longer period of time may be available to the security provider. References in this Article to a contract creating the security apply also to unilateral promises or undertakings creating a security (see IV.G.–1:102 (Scope) paragraph (4)).

If the required time span of five days is not observed, the consumer security provider can revoke the offer of security or avoid the contract or other juridical act creating the security within a “reasonable” period after having received the information or independent advice. This span of reasonable time is under normal circumstances five working days; however, the circumstances may suggest a shorter or longer period (sentence 2). This period is more flexible than the corresponding time span fixed by the first sentence, since the intending security provider cannot foresee when he or she will receive the draft of the offer or contract of security.

If no information or independent advice is given, the intending security provider can at any time revoke the offer or can avoid the contract or other juridical act (paragraph (4)). This rule must be understood in a broad sense: it must also apply if information is given, but turns out to be obviously insufficient so that it is not helpful for the intending security provider or even misleads as to the circumstances that have been relevant to the decision to assume the security.

Paragraph (5) will in practice be of limited relevance. In the early stage it is unlikely that any performances will have been rendered by any of the parties. However, in the cases addressed by paragraph (4), where no information or advice at all has been given and therefore the contract can be avoided at any time, performances may well have been rendered. The return of benefits received as a result of such performances is governed by the rules on unjustified enrichment in Book VII.

D. Mandatory provision

According to paragraph (2) of the preceding Article, the present Article is a mandatory provision in favour of the consumer security provider.

IV.G.–4:104: Form

The contract of security must be in textual form on a durable medium and must be signed by the security provider. A contract of security which does not comply with the requirements of the preceding sentence is void.

COMMENTS

A. General rule and exception

The general rule, to which this Article creates a restricted exception, is stated in II.–1:107 (Form) – “A contract or other juridical act need not be concluded, made or evidenced in writing nor is it subject to any other requirement as to form.”

The reasons for the exception are the same as those which justify corresponding requirements for assuming a personal security, especially a dependent personal security, enacted in the member states: *i.e.*, warning and protecting the providers of personal security generally and consumer providers of such security in particular.

B. Kinds of personal security

As to the instruments covered, all types of personal security are covered because otherwise no complete and effective protection of consumers can be achieved. In effect, since independent security as such is not accessible for consumers (see IV.G.–4:106 (Nature of security provider’s liability) sub-paragraph (c)), primarily the dependent personal security covered by Chapter 2 is affected. In addition, a co-debtorship for security purposes assumed by a consumer is subject to the rules of Chapter 4, as is expressly spelt out in IV.G.–1:106 (Co-debtorship for security purposes).

C. All terms to be in textual form on a durable medium

If it is to fulfil its function of clarification and warning, all terms of the contract of security must be in textual form on a durable medium. Terms which do not comply with this requirement are void (cf. sentence 2). Such partial nullity may not affect the validity of the written portions of the contract (cf. II.–1:109 (Partial invalidity or ineffectiveness)).

By virtue of I.–1:105 (Meaning of “in writing” and similar expressions) “textual form” means a text which is expressed in alphabetical or other intelligible characters by means of any support which permits reading, recording of the information contained in the text and its reproduction in tangible form. “Durable medium” means any material on which information is stored so that it is accessible for future reference for a period of time adequate to the purposes of the information, and which allows the unchanged reproduction of this information.

An electronic version of the security instrument on a disc or similar device suffices for these purposes. See also the EC Directive on Electronic Commerce 2000/31/EC of 8 June 2000, Article 9 (1).

Article 9 (2) of the Directive on E-Commerce allows member states to deviate from the Directive by requiring for a limited number of transactions a conventional writing, lit. (c) of Article 9 (2) allows such an exception for contracts of suretyship and collateral securities furnished by consumers. A few major member states have made use of this particular exception. It has been considered whether the present rules should provide such an exception. After extensive discussion it was decided that this option should not be used. At present, only few consumers will possess the necessary technical equipment so that, in fact, recourse to the electronic form will be relatively rare. Of course, this may change in future as more and more people may dispose of the equipment and increasing use may be made of it. However, a

problem of abuse will barely arise since the assumption of a personal security is an obvious “disadvantage” to the security provider.

D. Signature

The contract or other instrument must be duly signed by the security provider since this makes the instrument binding upon it. By virtue of I.-1:106 (Meaning of “signature” and similar expressions) a reference to a person’s signature includes a reference to that person’s handwritten signature, electronic signature or advanced electronic signature, and references to anything being signed by a person are to be construed accordingly. See also the EC Directive on Electronic Signatures 1999/93/EC of 13 December 1999, Articles 1 (2) and 5 (1) (a).

As far as the consumer security provider’s protection is concerned, the reasons given above apply equally. The electronic signature which is required is no less “complicated” than an ordinary hand-written signature so that the general warning effect is equally strong.

E. Mandatory provision

According to IV.G.-4:102 ((Applicable rules) paragraph (2), this Article is a mandatory provision in favour of the consumer security provider.

IV.G.-4:105: Nature of security provider’s liability

Where this Chapter applies:

- (a) an agreement purporting to create a security without a maximum amount, whether a global security or not, is considered as creating a dependent security with a fixed amount to be determined according to IV.G.-2:102 (Dependence of security provider’s obligation) paragraph (3);*
- (b) the liability of a provider of dependent security is subsidiary within the meaning of IV.G.-2:106 (Subsidiary liability of security provider), unless expressly agreed otherwise; and*
- (c) in an agreement purporting to create an independent security, the declaration that it does not depend upon another person’s obligation owed to the creditor is disregarded, and accordingly a dependent security is considered as having been created, provided the other requirements of such a security are met.*

COMMENTS

A. General

This Article specifically addresses three terms often utilised in personal securities and adapts these in the interest of protecting the consumer security provider. The remedy of adaptation is used in order to balance the opposite interests of the parties: that of the creditor in maintaining a security agreed upon and the security provider’s interest in being protected against harsh contract terms.

The Article is mandatory in favour of the consumer with the exception indicated in subparagraph (b).

B. Security without a maximum amount

Sub-paragraph (a) affects a security which does not contain a maximum amount. It is obvious that such a security is particularly risky for the security provider since the upper limit of the future obligation is not known.

The Article does not nullify such agreements but maintains them, although with a limitation. The unlimited security is converted into a limited security with a fixed amount. This amount is to be determined according to IV.G.–2:102 (Dependence of security provider's obligation) paragraph (3). This rule provides, in essence, that, unless a maximum amount can be determined from the agreement of the parties, the amount of the security is limited to the amount of the secured obligation at the time the security became effective. For details, cf. IV.G.–2:102 (3) and the Comments on it.

C. Subsidiary liability

Sub-paragraph (b) reverses the normal rule that a provider of dependent security is solidarily liable with the debtor of the secured claim, unless subsidiary liability had been agreed upon (IV.G.–2:105 (Solidary liability of security provider)). A consumer security provider is better protected by the contrary rule: liability is subsidiary, unless solidary liability has been agreed. The consequences and limits of this subsidiary liability are laid down in IV.G.–2:106 (Subsidiary liability of security provider) and need not be repeated here.

A higher degree of protection for the consumer security provider could, of course, be achieved if any contractual derogation from the basic subsidiary liability were to be prohibited. That, however, would go clearly beyond the state of the law in most member states. Nor does there seem to be any practical need or demand for change. In practice, creditors usually turn first against the debtor in any event before considering steps against a security provider.

D. No independent security

According to sub-paragraph (c), an agreement for an independent personal security is converted to a dependent security. The reason for this automatic conversion is the increased risk which an independent security implies: independence means that the accessory of the dependent security is excluded so that the security provider's obligation may exceed the amount and other terms of the secured obligation, if any, and the security provider may not invoke defences of the debtor.

In order to avoid complete nullity of a consumer's independent security, sub-paragraph (c) provides for the conversion of the independent into a dependent security, provided the requirements of the latter (other than the absence of a declaration that the security is independent) are met. The "requirements" of a dependent security are, in particular, the substantive and formal requirements laid down in Chapters 1, 2 and 4. For instance, since according to the definition of a dependent security in IV.G.– 1:101 (Definitions), a dependent security must purport to serve as security for an obligation of the debtor owed to the creditor, a pure payment guarantee without any underlying obligation to be secured could not be converted to a dependent security. This is confirmed by the contents of Chapter 2 on dependent personal security: the application of this Chapter presupposes that there is an obligation to be secured since this is the basis upon which the security "depends".

It goes without saying, that, once the requirements are met, the effects of the converted independent security are subject to Chapters 2 and 4.

E. Application to co-debtorship for security purposes

Only sub-paragraphs (a) and (b) of the Article are applicable to co-debtorships for security purpose. By contrast, sub-paragraph (c) deals specifically with independent personal security and therefore does not apply to co-debtorship for security purposes.

Sub-paragraph (a) deals with a case which will rarely occur with a co-debtorship for security purposes, namely one without a maximum amount. In this rare case, the policy expressed in IV.G.–2:102 (Dependence of security provider’s obligation) paragraph (3) must be adopted and slightly adapted: the security co-debtor’s obligation must be limited to the amount for which the primary full co-debtor was liable at the time when the secondary co-debtorship has been assumed.

According to sub-paragraph (b), a consumer security provider’s liability is subsidiary, unless the parties expressly had agreed otherwise. This provision will affect almost all cases of co-debtorship for security purposes, since normally these result in solidary liability. In order to prosecute the policy of sub-paragraph (b), it will be necessary to distinguish between two situations. On the one hand, if the co-debtors had simply agreed on creating a co-debtorship (which merely *implies* solidary liability), there is no “express” agreement on solidarity, as required by the closing words of sub-paragraph (b); consequently, the co-debtor for security purposes will then have only subsidiary liability. On the other hand, if they had expressly agreed upon solidary liability, this complies with the requirement of the closing words of sub-paragraph (b).

IV.G.–4:106: Creditor’s obligations of annual information

(1) Subject to the debtor’s consent, the creditor has to inform the security provider annually about the secured amounts of the principal obligation, interest and other ancillary obligations owed by the debtor on the date of the information. The debtor’s consent, once given, is irrevocable.

(2) IV.G.–2:107 (Requirement of notification by creditor) paragraphs (3) and (4) apply with appropriate adaptations.

COMMENTS

A. Basic idea

For ordinary dependent security, IV.G.–2:107 (Requirement of notification by creditor) requires the creditor to notify the security provider of certain important changes that affect the secured obligation. Apart from instances of non-performance or inability to pay, the required information refers to major events affecting the extent of the secured obligation, such as an extension of maturity (IV.G.–2:107 (1)) and major increases of the secured obligations under a global security (IV.G.–2:107 (2)).

For personal security assumed by consumers it seems appropriate to extend the basic idea underlying IV.G.–2:107 and to require annual information to be furnished to the consumer.

Such annual information is apt to remind the consumer periodically of the potential risk assumed which otherwise, especially in the case of long-term credits, might be forgotten. The requirement of annual information does not impose a major burden upon the creditor since business people usually strike such a balance for each account, often at the end of the calendar year or else at the end of the respective business year.

B. Debtor's consent

Contrary to IV.G.-2:107, the annual information under the present Article requires the debtor's consent (paragraph (1)). This difference between the two rules is justified by the fact that the two most important items to be communicated under IV.G.-2:107, *i.e.* the debtor's non-performance or inability to pay, concern vital events with respect to the secured obligation; they may trigger the security provider's duty to make payment to the creditor. Because of this importance for the security provider, these notifications must be communicated to the security provider even without the debtor's agreement. By contrast, the annual information required of the security provider under the present Article refers to the amounts of principal obligation, interest and other ancillary obligations and therefore affects very sensitive data. This justifies the requirement of the debtor's consent.

The second sentence of paragraph (1) supplements the preceding sentence by providing that the debtor's consent, once given, cannot be revoked by the debtor.

C. Scope of items to be disclosed

The text enumerates the principal obligation, interest and other ancillary obligations that have to be disclosed. It is the amount of each of these items that must be contained in the annual information. It is the sum total of these items that is relevant for the security provider in order to demonstrate the total potential indebtedness.

In order to be realistic, the figures to be given by the creditor must be as of the date of the information.

D. Exception

By referring to IV.G.-2:107 (3), an exception made by that provision is adopted and incorporated into the present Article. The annual information required by paragraph (1) need not be given if and in so far as the security provider already knows that information. The exception also applies if the security provider can reasonably be expected to know that information. Both actual and constructive knowledge may, *e.g.*, be held by a security provider who is the spouse of a director of the indebted company.

E. Sanction

Likewise, the cross-reference to IV.G.-2:107 (4) incorporates into the present Article the sanction which that provision establishes. For further details, cf. the Comments to IV.G.-2:107.

F. Mandatory rule

This Article may not be deviated from to the disadvantage of a security provider who is a consumer (IV.G.-4:102 (Applicable rules) paragraph (2)).

G. Application to co-debtorship for security purposes

The requirement to report annually on the amount of the debtor's outstanding obligations applies correspondingly to a co-debtorship for security purposes. The creditor must inform the "security debtor" about the obligations of the "real debtor" to the creditor.

IV.G.–4:107: Limiting security with time limit

(1) A security provider who has provided a security whose scope is limited to obligations arising, or obligations performance of which falls due, within an agreed time limit may three years after the security became effective limit its effects by giving notice of at least three months to the creditor. The preceding sentence does not apply if the security is restricted to cover specific obligations or obligations arising from specific contracts. The creditor has to inform the debtor immediately on receipt of a notice of limitation of the security by the security provider.

(2) By virtue of the notice, the scope of the security is limited according to IV.G.–2:109 (Limiting security without time limit) paragraph (2).

COMMENTS

A. General

For providers of dependent or independent security – whether consumers or not – these Rules provide protection by requiring that such securities, subject to certain exceptions, must have either an agreed time limit or be subject to the possibility of a time limit being set by any party. For the consumer security provider, however, even securities with an agreed time limit can be regarded as creating an intolerable level of risk: consumer security providers will typically lack business experience; if they assume a security which is agreed to cover unspecified future obligations of the debtor over a period of several years they might not be able to foresee the extent of obligations of the debtor which over the course of time could fall under this security. This Article accordingly provides additional protection for consumer security providers by allowing them to limit the duration of securities with an agreed time limit if these securities run over a period of three years or more.

B. Scope of application

Securities with a time limit. The Article applies to securities with an agreed time limit only. This limitation may seem surprising since the need to limit a security obviously is more pressing if the parties had not agreed upon a time limit. However, this gap is easily explained by the fact that securities without an agreed time limit may be limited under IV.G.–2:109 (Limiting security without time limit) read with IV.G.– 4:102 (Applicable rules) paragraph (1) and IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (c)).

Applicability to all types of security. The Article is applicable regardless of the type of personal security assumed by the consumer security provider. The fact that the Article refers to IV.G.–2:109 (Limiting security without time limit) in the Chapter on dependent security, does not give rise to any difficulties since the provisions of that Chapter are applicable to consumer providers of an independent security and consumer security providers in a co-debtorship for security purposes by virtue of IV.G.–4:106 (Nature of security provider's liability) sub-paragraph (c) and IV.G.–4:102 (Applicable rules) paragraph (1) respectively.

Excluded cases. According to paragraph (1) sentence 2, the right to limit a security on the basis of this Article does not apply where the security is restricted to cover specific obligations or obligations arising from specific contracts. This exception is intended to protect the creditor who may have concluded the contract from which the secured obligations arise only on the strength of the security provided in relation to these obligations. Moreover, the risk of an unforeseeable extent of the consumer security provider's liability appears to be less pressing in these situations as the reference to a specific obligation or a specific contract should make the potential scope of the security more easily determinable even for the consumer security provider.

Scope of application limited. The scope of application of the Article is further in effect limited as a result of IV.G.-4:106 (Nature of security provider's liability) sub-paragraph (a) to securities with an agreed maximum amount. The right to limit the scope of a security is of interest especially in cases where the security is agreed to cover not only existing but also future obligations. Should a security lack an agreed maximum amount, such a fixed amount will be determined on the basis of IV.G.-2:102 (Dependence of security provider's obligation) paragraph (3) read with IV.G.-4:106 (Nature of security provider's liability) sub-paragraph (a). Often in cases of securities covering future obligations the amount of the secured obligations at the time the security becomes effective, *i.e.* normally at the time the security is assumed, will be very low or nil, so that a future limitation on the basis of the present Article will not be of much interest for the security provider in these situations.

C. Limitation of security by consumer security provider

Limitation by security provider giving notice. The security may be limited by a simple notice; contrary to IV.G.-2:109 (Limiting security without time limit), only the security provider is entitled to limit the effects of the security.

Limitation after minimum period of three years. A security with an agreed time limit may only be limited by the security provider if at least three years have passed since the security became effective. It is assumed that even the consumer security provider should be able to foresee the risks to be incurred over such a period of limited time, so that the additional protection provided by this Article does not appear to be necessary in these cases.

Period of notice. As in IV.G.-2:109 (Limiting security without time limit), the limitation of the security can become effective only after a period of notice of at least three months has expired. See Comments on that Article.

D. Effects of limitation

Limitation of the scope of the security. For the limitation of the scope of the security, paragraph (2) refers to IV.G.-2:109 (Limiting security without time limit) paragraph (2). For the effects of the limitation under this provision see the Comments on that Article.

Creditor's duty to inform the debtor. According to paragraph (1) sentence 3, the creditor has to inform the debtor on receiving a notice of limitation of the security by the security provider. This provision is necessary because often not only the creditor, but also the debtor will have relied on the security running until its agreed time limit.

Limitation according to this Article and agreed time limit for resort to security. The limitation of the security by the security provider according to this Article does not in itself create a time limit for resort to the security within the meaning of IV.G.– 2:108 (Time limit for resort to security). However, should the parties have agreed on such a time limit for resort to the security, it will not be affected if the security provider limits the security according to the present Article. While the scope of the security will be limited, the creditor will still be able to resort to this security until expiration of the original time limit agreed by the parties.

BOOK V

BENEVOLENT INTERVENTION IN ANOTHER'S AFFAIRS

CHAPTER 1: SCOPE OF APPLICATION

V.–1:101: Intervention to benefit another

(1) This Book applies where a person, the intervener, acts with the predominant intention of benefiting another, the principal, and:

(a) the intervener has a reasonable ground for acting; or

(b) the principal approves the act without such undue delay as would adversely affect the intervener.

(2) The intervener does not have a reasonable ground for acting if the intervener:

(a) has a reasonable opportunity to discover the principal's wishes but does not do so; or

(b) knows or can reasonably be expected to know that the intervention is against the principal's wishes.

COMMENTS

A. General

Terminology. The provisions of this Chapter contain rules regulating the legal relationship between two persons where one party, either for good reasons or with the subsequent approval of the other, has chosen to intervene in the other's affairs for the furtherance of the latter's interests. This law of benevolent intervention in another's affairs (or *negotiorum gestio*) thus governs the rights and duties of the party acting (in the various laws of the Member States presently termed, *inter alia*, *διοικητής allotριών*, *forretningsfører*, *gérant*, *Geschäftsführer*, *gestor*, *gestore*, *megbízás nélküli ügyvivő*, *zaakwaarnemer*) and the party to be benefited (the *belanghebbende*, *dominus*, *dono do negócio*, *dueño*, *forretningsherre*, *géré*, *Geschäftsherr*, *huvudman*, *interesado*, *interessato*, *kyrios*, *maître de l'affaire*, *ügy ura*). In the English version of these Articles, the *dominus* is referred to as the "principal". The active party is referred to as the "intervener".

Requirements of benevolent intervention. According to paragraph (1) of the present Article and V.–1:103 (Exclusions), benevolent intervention has two positive requirements (V.–1:101(1)(a)) and three negative requirements. There must be (i) an act which is undertaken with the predominant intention of benefiting another (the principal) and (ii) a reasonable ground for this intervention. Additionally the party acting must not be either (iii) obliged or (iv) otherwise authorised under other rules of the legal system (that is to say, rules outside the law of benevolent intervention) to act in relation to the benefited party, or (v) under an obligation to act in relation to a third party. In addition sub-paragraph (b) of paragraph (1) of the present Article makes it clear that the provisions of this Chapter also apply if the intervener intervenes without reasonable ground in the affairs of the principal, but the activity is approved by the latter without such undue delay as would adversely affect the intervener. The approval by the principal takes the place of the (missing) reasonable ground for acting in

the principal's sphere of interest. There is no further requirement in that the intervener must manage an affair which from an objective perspective is the affair of another (that is to say, an extraneous affair in relation to the intervener); the single decisive element is that the intervener acts with the predominant intention to benefit the other. It is the intention to benefit another, acted upon on the basis of a reasonable ground, which attributes the act to the principal.

Illustration 1

G is the owner of a very ugly factory site. In order to save his neighbour the awful sight of the buildings, G, acting on his own initiative, plants a row of trees along the property boundaries. G may have acted with the predominant intention to benefit his neighbour, but he is not an intervener because he has not acted upon his intention to benefit another on the basis of a reasonable ground. He has imposed an enrichment on his neighbour.

Illustration 2

In order to apply an emergency bandage on a badly injured pedestrian, P, a passer-by G uses dressing material. G will qualify as an intervener in relation to P irrespective of whether she uses her own dressing material or if she smashes the window of a car belonging to a third party in order to get hold of dressing material lying on the back seat. In relation to the third party, this act qualifies as a justified act of emergency within the meaning of VI.-5:202 (Self-defence, benevolent intervention and necessity) paragraph (2) for which G is liable to provide reasonable compensation.

Protection of the principal against officious intermeddling. In order to protect the principal from officious intermeddling by others, paragraph (2) makes the clear demand that the intervener must be directed as far as possible in the circumstances by the wishes of the principal, so far as the intervener is in a position to identify them. Paragraph (2) is an ancillary norm serving as a particularisation of paragraph (1)(a).

Special forms of the law of benevolent intervention are not within this regime. The provisions of this Chapter have as their subject matter only the so-called justified management of another's affairs and the rights and duties of the intervener and the principal which arise out of that. If someone interferes in the affairs of another without reasonable ground and that other is not moved to approve the intervention, then the rights and obligations of the parties remain subject to other areas of the law – in particular the law on non-contractual liability for damage and the law on unjustified enrichment – and not the law on benevolent intervention. The same correspondingly holds true where a person intermeddles in the affairs of another in order to pursue that person's own interests, and that is so irrespective of whether this happens intentionally or by mistake (for example, because that person meant to advance his or her own interests, but has actually furthered another's interests). Contrastingly, the provisions of this Chapter are applicable where the intervention is justified, but the intervener infringes a duty which arises out of the justified management of another's affairs. See for more detail Chapter 2 (Duties of intervener).

Benevolent intervention as a defence within the framework of the law on non-contractual liability for damage. Justified benevolent intervention in advancement of another's interests constitutes a ground of defence in respect of a non-contractual liability in damages which would otherwise be imposed. That is expressly set out in VI.-5:202) (Self-defence, benevolent intervention and necessity) paragraph (2).

Illustration 3

As a result of a traffic accident P is rendered unconscious and locked in a car. G smashes a car window in order to be able to unlock the door from the inside and pull P out of the car. G is not liable to P under the law on non-contractual liability for the damage caused to the car.

Burden of proof. These rules regard the question of burden of proof as belonging to substantive law. Rules on burden of proof are applicable when it is not possible to clearly establish the circumstances of the case. Within the law of benevolent intervention the general principle applies whereby each party must make out the circumstances favourable to that party's case and in case of dispute prove them. When a given party is not able to do that, the decision in the case must be adverse to that party.

Illustration 4

The facts are the same as in Illustration 3, save that in smashing in the window G is injured. Both parties claim compensation – P under the law on non-contractual liability on account of property damage and G under the law on benevolent intervention (V.-3:103 (Right to reparation)) on account of the personal injury suffered in acting as intervener. If it is disputed and cannot be established whether G really acted for the purpose of rescuing P, then P's claim to compensation will succeed, while G's claim will fail.

Proof. By contrast, all questions which are related to the problem whether a given fact is to be regarded as proven are part of the law of procedure. They are therefore not the subject matter of these rules.

Illustration 5

The facts are again the same as in illustration 3. However, P later maintains that G smashed the window only (or at least primarily) for opportunistic reasons, meaning to steal the camera lying on the passenger seat of P's car. (National) procedural law determines under what conditions and to what extent G's case is supported by presumptions triggered by a *prima facie* case. (For example, G might prove that P was in fact subsequently liberated from the car by G, from which it may *prima facie* follow that when breaking the glass beforehand G was acting predominantly with the intention of rescuing P.) The same goes for the question as to what concrete circumstances place upon P an onus of introducing evidence to rebut a *prima facie* case. (For example, P might seek to show that G was later found with the camera and unable to offer a convincing explanation for having it and that G had made no serious attempt to free P.)

B. The activities covered

'Acting' for another. V.-1:101(1) states that the provisions of this Book apply where a person 'acts' for another. The type of act required is not further qualified. It follows that every type of act may be considered a benevolent intervention – services as much as making things (or money) available for use or paying another's debt. This wide scope of application embraces acts having legal effects as well as acts merely changing the physical state of affairs. A benevolent intervention may consist in the conclusion of a contract or giving notice to terminate a legal relationship just as much as it may consist in effecting repairs, making a telephone call, keeping property safe, giving a warning, removing a vehicle, cutting back trees

overhanging the public thoroughfare, feeding (or, in a case of emergency, killing) animals, and so forth. All of these are ‘acts’ within the meaning of that term in V.-1:101. That of course does not exclude the possibility that certain of the following provisions of this Book may be entirely or at any rate predominantly directed towards one form of acting rather than another, be it acts having legal effects or acts of a merely physical import. A case in point where it is the former rather than the latter which is in focus is V.-3:106(Authority of intervener to act as representative of the principal) and which thus necessarily concerns only juridical acts. By contrast, V.-3:103 (Right to reparation) concerning reparation will as a rule only come into play in respect of acts of a merely physical significance.

Acts to protect another’s person are included. Furthermore, it is clear that the concept of benevolent intervention in another’s affairs as understood in these rules is in no way limited to acts for the protection of another’s patrimonial interests. Instead it includes within its compass acts for the protection of another’s person and hence such acts as bandaging the wounded, bringing the injured to hospital and saving someone from a dangerous situation (as in Illustration 3 above).

One-off activities and long-term undertakings. The ‘act’ can consist in an isolated, one-off act as much as an enduring matrix of activities such as the administration of a bank deposit or the management of another’s farm or business. To cater in particular for such longer term activities the provision in V.-2:101 (Duties during intervention) paragraph (c) (concerning the on-going duty of the intervener to provide information) has been devised; for activities which start and finish in a momentary act that provision will not come into play.

Omissions. It is theoretically conceivable that a benevolent intervention might even consist in an omission. Practically speaking, however, that can rarely be the case, not least because the commonest situations in which the outward appearance of a person’s conduct would lend itself to a benevolent intervention will often be absorbed by the law of contract and in such circumstances, in accordance with V.-1:103 (Exclusions) sub-paragraph (a), the rules of contract law will claim priority over the law of benevolent intervention in another’s affairs.

Illustration 6

A notary, acting contrary to instructions, does not forward a client’s money to the tax authority because the notary has learned in the meantime of a change to the taxing statutes whereby tax is no longer payable. A garage, acting in the interest of a customer, does not repair the car brought in to be repaired in order to save it from the grasp of an occupying power. Conduct of this kind would normally be construed as performing a contractual obligation and therefore as being outside the law of benevolent intervention in another’s affairs from the very outset.

Actions contrary to law or public policy. Acts of an intervener which are unlawful or contrary to public policy are not *per se* excluded by the Articles from their scope of application. Such a rule does not appear necessary and, moreover, it would be dangerous to introduce one because in defined circumstances it could be the cause of misunderstanding. Certainly, under normal circumstances the act of the intervener must not be either prohibited by law or contrary to public policy. However, that follows from the fact that in both of those cases the reasonable ground for intervention would usually be missing.

Illustration 7

P, a member of a band of thieves, is ill. Disproving the adage that there is no honour among thieves, P's friend G undertakes P's "workload" on P's behalf. Under the law of benevolent intervention P can have no claim against G to the money stolen from third parties by G on P's behalf (and correspondingly G has no claims against P).

Emergency situations. However, it is conceivable that in situations of emergency even otherwise illegal conduct might, in special circumstances, be reasonable. The emergency might compel an intervener to act in a way which is prohibited by law or which, under normal circumstances, would be regarded as contrary to public policy.

Illustration 8

A person is only able to obtain the release of a travelling companion, who is being wrongfully held in custody in a corrupt foreign state, by paying bribes. Although bribery is prohibited and although the legal system to which the intervener and the principal are subject (be it by reason of common nationality or habitual residence) would also usually disapprove of the bribery of foreign officials, in such extreme conditions the act of bribery might still be reasonable in relation to the principal. The intervener can consequently demand reimbursement of the expenditure incurred in making the bribes: see V.-3:101 (Right to indemnification or reimbursement).

Disallowed interventions. It may nonetheless be the case that even after considering the situation of emergency, a given conduct is regarded by a legal system as prohibited for reasons of overriding significance. In that event it is unreasonable for the purposes of the law of benevolent intervention to disregard the prohibition.

Illustration 9

Under the law of a Member State it is prohibited on the basis of a particular statutory provision to pay a ransom to a kidnapper. A son who ransoms his father from the clutches of his captors has no claim against his father for reimbursement on the basis of benevolent intervention. The son has no reasonable ground to intervene in this manner.

Acts of an inherently personal nature excluded. Acts which are of such an inherently personal nature that they can only be done by an individual in person are by their very nature excluded. That is not expressly stated in the Article, but should be understood as inherent and can be inferred from V.-3:106 (Authority of the intervener to act as representative of the principal) which under certain conditions confers on the intervener the authority to act in a way which binds and favours the principal directly in relation to third parties (i.e. to act as the principal's representative). Acts which cannot permissibly form the subject-matter of a representation relationship cannot permissibly be made the subject-matter of a benevolent intervention in another's affairs. In so far as the law of succession does not allow a person to execute a will for another, it will not be possible for an intervener to undertake such an act as benevolent intervener for the testator. A similar point can be made in relation to a juridical act which purports to change another's marital status or parental responsibility or to alter an individual's name. However, a person is also precluded from putting forward a particular philosophical or political viewpoint on behalf of another – for example election publicity as benevolent intervener for a political party.

Conducting litigation as a benevolent intervener. An act within the meaning of the law of benevolent intervention in another's affairs can also consist in conducting litigation. In that case, however, one must distinguish between two fundamentally different situations, namely conducting litigation in one's own name and conducting litigation in the name of the principal. The first situation, in which the intervener litigates against a third party in the principal's interest but in the intervener's own name (for example, in pursuing through the courts a claim to the purchase price where in a case of necessity the intervener has sold goods belonging to the principal), does not throw up any special issues. The intervener may even be obliged to take such action in defence of the principal's interests (in consequence of prior acts) as part of the duty to continue the intervention within the bounds set out in V.-2:101 (Duties during intervention) paragraph (2). More difficult, by contrast, is the problem of whether and under what conditions an intervener may litigate in the name of the principal if the latter is hindered personally from attending to affairs. A case in point would be, for example, an attempt by an intervener to commence legal proceedings in order to prevent a statutory limitation of the principal's claim to an unpaid purchase price which threatens to become time-barred. Whether such a form of undertaking the affairs of another is possible or whether the matter remains reserved to the principal as something which can only be carried out personally is not determined by these rules. Rather they presuppose, in keeping with most jurisdictions of the EU, that one is concerned here with a question of procedural law which must be resolved by the applicable law of procedure. The position adopted in the majority of national procedural laws appears to be that an intervener will be permitted by a court to conduct litigation on a provisional basis up to a certain point in time, determined by the court, when a mandate or power of attorney must be filed, in default of which the action will be dismissed.

C. The intention predominantly to benefit another (paragraph (1))

Meaning of 'benefiting'. As regards the positive requirements of benevolent intervention in another's affairs, as stated already the text operates with one subjective element (intention to benefit) and one objective element (reasonable ground). As a first essential, the intervener must act with the intention of *benefiting* another. The word 'benefiting' is to be understood in this context as having a wide significance; in particular it does not relate merely to benefits of a type falling within patrimonial law in the sense of an enrichment. That follows already from the explanation in nos. 8-9 above of the concept of an 'act'. See also Illustration 3 above.

The success of the venture is not essential. Furthermore, it is important to recognise that it is the *intention* of benefiting another that matters, not an actual benefit as such. This intention turns only on the *prospective* utility which, at the time of acting, might be anticipated and not the *resultant* usefulness which may or may not have emerged after the act has been completed or stopped. The intervener must therefore have acted with the intention of managing another's affairs for that other's benefit, assessed at the time the intervener is active, but as a fundamental principle this good intention is sufficient. Whether or not the act was ultimately successful (the resultant benefit) is not a criterion and is immaterial. In this way the law of benevolent intervention in another's affairs is distinguishable from the law of unjustified enrichment.

Illustration 10

P suddenly loses consciousness behind the wheel of her car. Her car comes to rest over a sheer drop; she is rescued and taken to hospital. P's car threatens to run down the slope. G, who operates a breakdown service and has been informed of the situation by a third party, resolves to tow the car back on to the road using a winch and bring it to

P's house. Due to a latent defect in the material, the steel cable snaps; the car tumbles down into the void. G acted with the intention of benefiting P. That this intervention ultimately resulted in more harm than good does not alter the matter.

Benefiting another, not intending to pursue one's own interests. The intervener must have acted with the intention of benefiting *another*. A person who pursues their own interests is not a benevolent intervener. Moreover, merely having in fact undertaken another's affairs will also not suffice if that was done inadvertently or unwittingly. Someone who assumes they are discharging their own obligation and acts accordingly, in reality discharging another's obligation, is not acting as a benevolent intervener. A case in point would be a married man who maintains a child of his wife in the assumption that he is the father, though in reality another man is the biological father of the child. In the absence of a special statutory regime (in this case, in family law), such cases remain to be dealt with within the law of unjustified enrichment.

Illustration 11

From a vague report provided by children it appears that G's son has broken a neighbour's window pane with a ball. On that basis G pays for the damage. Later it emerges that a different boy was responsible. G does not act as intervener for either the boy responsible or (so far as they would be vicariously liable for the property damage caused by their son) the boy's parents. Any claim for reimbursement of the payment made can be made only in accordance with the law of unjustified enrichment. It will be for the law of unjustified enrichment to determine whether G has a claim against the other boy, or the parents of the other boy, or can instead demand a repayment from the neighbour.

Illustration 12

A music publishing company continues to make use of publishing rights, assigned to the company for its use for a limited time only, after the death of the composer in the erroneous supposition that the rights had fallen into the public domain. The publishing company cannot set off against the claim of the composer's successors for surrender of the proceeds a claim based in benevolent intervention for remuneration for its commercial activity in marketing the music. The company had not intended to benefit the composer's successors.

No possibility of approval for acts undertaken for own benefit. In contrast to the element of reasonable ground (paragraph (1) sub-paragraph (a) in conjunction with paragraph (2)), the subjective requirement of an intention to benefit another cannot be replaced by a timeous approval of the act by way of ratification. The justification for the possibility of an approval of an intermeddler's act is based on the assumption that the intermeddler was acting for the person subsequently giving their approval for what has been done, so that there is, as it were, in retrospect a meeting of minds between the parties. According to the rules of benevolent intervention in another's affairs an approval by the principal is not therefore an option if the intervener has been acting mainly in the intervener's own interest and just happened to have a secondary aim of benefiting the principal. That, however, does not preclude the possible application of the rules on representation. Under II.-6:111 (Ratification) paragraphs (1) and (2) a principal can ratify a transaction which a person purporting to be the principal's representative, but acting without authority, has concluded with a third party. In this context it does not matter whether the false representative acted with the intention of benefiting the principal or for his or her own benefit.

Predominant' intention of benefiting another. In order to evade the problem arising where an intervener acts with a mixture of interests in mind – that is, the problem that hardly anybody ever acts exclusively in another's interest – paragraph (1) requires that the intervener must intend *predominantly* to benefit the principal. Where the pursuit of another's interest and the pursuit of one's own interest have been combined together, it is sufficient that the former is, at the margin, uppermost. This excludes all argument that an intervener will have a right to reimbursement when in substance acting for his or her own advantage merely because some lesser part of the intention was to benefit the principal.

Illustration 13

A genealogist (G) makes his living by, among other things, responding to public announcements of apparently 'heirless' estates. Such publications arise where a person dies leaving an estate and the court responsible for matters relating to intestate succession to the estate is compelled according to the tenor of the documentation before the court to assume that the deceased died without relatives entitled to succeed to the estate. If such relatives do not identify themselves within a given time limit, the estate will pass to the public exchequer. G is successful in seeking out such relatives. He offers, in exchange for a reward amounting to 20% of the estate, to provide them with requisite details and to conduct the process of winding up the estate. To demonstrate his seriousness, he reveals to them preliminary information of a rudimentary kind. However, that information turns out to be sufficient for the relatives to locate the court with responsibility for the succession and to press their claims to the inheritance. G has only collaterally sought to advance the interests of the relatives. His main concern was the conclusion of a contract into which, however, the relatives did not in fact enter. G has no claim against the relatives and in particular none arising out of V.-3:102 (Right to remuneration). A second reason to deny such a claim for remuneration would be that under Art. 9 of the Directive 97/7 on protection of consumers in respect of distance contracts no consumer is compelled to pay for unsolicited services. This provision does not, however, mean that European Community law has completely abolished claims for expenditure in respect of unsolicited services (see II.-3:401 (No obligation arising from failure to respond) paragraph (2)(a)), but it does mean that its value judgments must be reflected by the law of benevolent intervention.

Illustration 14

Farmer F notices that following a storm a tree in the highway has fallen down and is lying across the street. Being a weekend, nobody can be contacted at the local authority, which is responsible for the tree and the safety of the street, who will be able to react promptly. If F pulls the tree trunk off the road with a tractor, F acts as intervener for the local authority (V.-1:102 (Intervention to perform another's duty)). That remains the case irrespective of the fact that a collateral benefit of the activity is to enable F to reach part of F's farm which could otherwise only be reached by making a detour.

Illustration 15

Grown up children discharge their father's unpaid tax liability in order to prevent the Revenue from impounding some valuable pictures belonging to their father. It is no objection to recognising the existence of a benevolent intervention that the children in making the payment also had in mind their prospective inheritance of the pictures on their father's eventual death.

Illustration 16

The majority of the owners of land on an industrial estate make a request to the responsible local authority for the construction of a spur to connect with a nearby dual carriageway. The local authority consents on the basis that the owners make a substantial contribution to the costs of construction. Owners A and B are agreeable. C agrees too in principle, but makes it clear from the outset that he is not prepared under any circumstances to pay more than € 100,000. A and B (but not C) subsequently conclude a contract with the authority to make a contribution to the construction costs; the authority undertakes to construct the road. The resultant costs amount to €770,000. Quite independent of the fact that C expressly ruled out a greater contribution to the costs of construction, A and B have no claim against C in benevolent intervention because they did not act “predominantly” with the purpose of benefiting C.

Acting in pursuance of a void contract. A special case (which is not the subject of an explicit rule) in which an intention *predominantly* to benefit another is missing is when a person undertakes an act in the erroneous assumption that they are performing a contractual obligation which they believe they have incurred to the principal. Typical cases concern performances rendered on the basis of contracts which are void for illegality, want of required form, or because the parties are not truly *ad idem*. These rules proceed on the basis that claims in respect of such performances rendered fall within the domain of the law of unjustified enrichment and not within the law of benevolent intervention in another’s affairs. Illustrative cases involve the repair of another’s car pursuant to a void contract for services, or the acquisition of property in one’s own name in supposed discharge of a void mandate. A few of the higher courts in Europe admittedly judge these latter cases differently at present, but within those countries their solution is anything but undisputed. Speaking in favour of the solution chosen here is the fact that those who act on the basis of a void contract are certainly, from a technical point of view, acting ‘without authority’ (see V.–1:103 (Exclusions) subparagraph (a)), but they also act without the “predominant” intention of benefiting another, seeking rather to advance their own interest by executing the concluded bargain.

Similar cases. The position is no different when a person discharges a debt as a result of a misapprehension as to the legal situation – for example, where a person mistakenly assumes that they are obliged on account of a supposed unjustified enrichment or non-contractual liability for damage to make a monetary payment. Here too an intention predominantly to benefit another is missing and consequently there is no benevolent intervention. Distinguishable, however, is the case of discharge of a duty to render assistance arising under criminal law (on which see further Comment B under V.–1:103 (Exclusions)). Moreover, one who erroneously supposes that a person in need has a right to assistance nonetheless acts predominantly with the intention of benefiting that person. The (unfounded) concern of the rescuer that they may otherwise be subject to a claim for damages blends into the background in a real life situation.

Collateral advancement of a subordinate personal interest can affect the quantum of the intervener’s claim. It not uncommonly transpires that an intervener is predominantly acting to advance the interests of the principal, but at the same time has the advancement of his or her own objectives at the back of the mind. As stated above, that will not exclude the application of the rules on benevolent intervention in another’s affairs. The (subordinate) collateral advancement of one’s own purposes may call for consideration, however, in determining the legal consequences of the intervention – in particular in assessing the

quantum of damages or reimbursement of expenditure to which the intervener is entitled. That is the case primarily where the intervener and principal were exposed to a common danger (see V.-3:104 (Reduction or exclusion of intervener's rights)).

Illustration 17

Adjacent plots of land belonging to G and P respectively are situated on a slope in the hills, G's land lying immediately below that of P. After heavy rainfall and especially when settled snow melts, the stream which flows down the hill and along both plots of land overflows and floods the land. G knows from experience that when the water has reached P's house it will flood into P's kitchen if nothing is done. When the water levels upstream from P's land once more rise ominously high, G commissions a contractor to deal with the problem, P being away from the scene and not reachable by telephone. G has a claim against P for reimbursement in respect of the costs arising from commissioning the contractor. That claim will be reduced under V.-3:104(2), however, if and so far as G's house would similarly have been flooded had G not commissioned the contractor to prevent the flooding of P's house.

Intervener and principal: general observations. Fundamentally anybody can be an intervener or a principal. That applies to legal persons as much as to natural ones. In many cases it will be not-for-profit organisations, formed as legal persons, which act as benevolent interveners (though this does not exclude the possibility that in the circumstances of the case they may often fall to be regarded for the purposes of V.-3:104 (Reduction or exclusion of intervener's rights) paragraph (1) as having manifested an intention at the time of their intervention not to assert their rights as interveners). Equally children may act as interveners or be principals (but see also the rules for their protection in V.-2:102 (Reparation for damage caused by breach of duty) paragraph (3), V.-2:103 (Obligations after intervention) paragraph (2), and V.-3:104 (Reduction or exclusion of intervener's rights)). Whether mentally disabled persons are capable of acting as benevolent interveners depends essentially on whether they are capable of mustering sufficient powers of comprehension as to be able to resolve to intervene predominantly with the intention of benefiting another. It is even conceivable that a benevolent intervener may act for a person not yet in existence (e. g. a foetus); though here the general rule must be observed that only a person can be subject to legal obligations.

Multiple interveners. Where multiple interveners act, it will depend on the circumstances of the individual case whether or not they are to be regarded as solidary debtors. According to general rules, they will usually be solidary debtors if (but only if) they carry out one and the same undertaking. They will be independent debtors however if they are pursuing different tasks.

Illustration 18

For lack of expertise, A is not in a position to put right certain damage to water pipes in the home of a neighbour N. A calls a plumber and (not acting as a representative of N) commissions the plumber to undertake the repairs. If the repairs are carried out unprofessionally, A will not be vicariously liable to N. However, under V.-2:103 (Obligations after intervention) paragraph (1) A is obliged to assign to N the right to damages under the contract made with the plumber which will entitle N to claim damages from the plumber.

Illustration 19

The facts are as in illustration 18 except that, instead of engaging the plumber, A merely alerts the plumber to the burst pipe and leaves to the plumber the decision whether or not to intervene. If the plumber does intervene, then both A (because of alerting the plumber) and the plumber constitute benevolent interveners. As regards the defective execution of the repairs, however, they do not constitute solidary debtors; in relation to that activity, A was not a benevolent intervener at all.

Book III. Chapter 4. Where interveners are liable as solidary debtors, their obligations towards the creditor principal to settle their liabilities will follow, by means of analogy, the rules of Book III. Chapter 4.

Identifying the principal. The intervener is the person who has acted for another; the principal is generally the person whose interests the intervener sought to look after. There can only be one principal or class of co-principals whom the benevolent intervener intends to benefit *predominantly* – i.e. to benefit above all others. The approach by which the principal is defined is thus a subjective one. It depends according to the basic rule on the intentions of the intervener. In the circumstances circumscribed by V.-1:102 (Intervention to perform another's duty) however, there is an exceptional case in which an "objective" approach supplements the core "subjective" one.

Illustration 20

In the immediate aftermath of a railway disaster which has resulted in a large number of victims, some private individuals in the vicinity of the accident rush to give assistance. Two of the helpers injure themselves when breaking the window of an overturned carriage, supposing there are survivors inside. There are in fact five survivors whom it is possible to rescue. Those five survivors, as well as the railway company (see V.-1:102 (Intervention to perform another's duty)), are principals in relation to the rescuers. As between the railway company and the rescued victims, however, the railway company alone will be accountable if it is liable vis-à-vis its passengers: V.-3:105 (Obligation of third party to indemnify or reimburse the principal).

The determinability of the principal at the moment of intervention. The intention of the intervener to benefit another must relate to the principal. That does not mean that the intervener must have known the principal personally or by name; nor does it even mean that the intervener must have had a specific person in mind to benefit. It does mean, however, that at the moment of intervention the principal must at least have been ascertainable. Unless that requirement is satisfied there can be no benevolent intervention "for another".

Illustration 21

A company which runs a bus passenger service and as a precaution in case of accident keeps one or two vehicles in reserve in its depot does not act on behalf of someone who is responsible for a subsequent accident and causes damage to its fleet when it keeps those maintained vehicles on stand-by. Consequently, the company cannot under the rules of benevolent intervention in another's affairs demand from the person causing the accident a proportion of the costs of keeping the vehicles in reserve. That person was not identifiable at the time the decision was taken to establish a reserve fleet. (Quite aside from this the company may have acted predominantly to pursue its own interests. That is because such vehicles are not primarily held in reserve in

anticipation of an accident. Rather they are maintained first and foremost in order to provide uninterrupted service to customers whenever a vehicle has to be taken out of service due to a breakdown).

Illustration 22

A water leakage occurs in a coal mine. The responsible authority prohibits the owner of the mine from pumping out the water, because it fears damage to the water table in summer. The costs of pumping out the mine later are considerably higher than if the measure had been undertaken immediately; in addition the mine owner suffers loss of earnings as a result of this delay. The mine owner is not a benevolent intervener, however, in delaying the draining of the mine because an indeterminate number of people benefits from the omission: a spa, hotels and bed and breakfast accommodation, retailers, other residents of the town and even traders in the towns through which the guests of the health resort, who would otherwise have stayed away, have to travel.

Where the principal is unknown to the intervener. As already indicated, it is not necessary that the benevolent intervener should know the principal personally. It is quite possible for an intervener to act to benefit an unknown person. Someone who is on the point of rescuing a stranger's property does not need to know who the owner is or which other persons, if any, have proprietary entitlements in respect of the property in order to be able to act as intervener in relation to them. The general intention to aid those who have some patrimonial interest in the property suffices. To that extent the 'subjective' method of identifying the principal also subsumes certain 'objective' elements within it. Moreover, in situations of emergency which require a rapid response it is quite unrealistic to expect the intervener to entertain precise thoughts about who exactly will benefit. In such cases the principal is that person whom the intervener would reasonably have contemplated as the object of the assistance had the intervener been able to give the matter full consideration at leisure. In this context it is also possible to bring into focus considerations of what is customarily the case. Someone who protects a small child from the dangers of road traffic, for example, might intend in a case of doubt to act also for the child's parents.

Mistake about the person benefited. It is correspondingly not fatal to the existence of a benevolent intervention in another's affairs that the intervener is mistaken as to the person who is in fact benefited by the intervention. In the case of a change in the supposed benefited persons, identification of the legally relevant parties turns on the material rather than the personal intentions of the intervener.

Illustration 23

Someone who pulls a car out of a ditch, thinking that the car belongs to X, but who later learns that the car is in fact owned by Y, acts with the intention of furthering the interests of Y: the intervener acts with the intention of benefiting the owner of the car, albeit that this is coupled with a mistaken assumption as to the identity of the owner. The same applies even if it later turns out that the car actually belongs to the person who has pulled it out. However, in this situation the congruence of the person acting and the person benefited takes the case outside the scope of benevolent intervention.

Indirect beneficiaries are not principals within the sense of V.-1:101. On the other hand, the boundary is reached when the intervener obviously intended to benefit a particular person and it subsequently emerges that third parties have also profited from the intervention (or

would have profited, had the intervention been successful). Third parties of that type, in the ordinary course of life, are not within the intervener's contemplated class of beneficiaries. Such third party beneficiaries come into consideration as principals at most in the special circumstances of V.-1:102 (Intervention to perform another's duty) (on which see the comments to that Article).

Illustration 24

A person who protects a neighbour's house from a fire does not generally act for the purpose of benefiting the insurance company with which the neighbour has a fire insurance policy and which would otherwise incur a financial liability. Someone who is injured while endeavouring to free a person from a glass window frame which has fallen on that person's head during the person's course of employment would not have a claim to compensation under V.-1:101, in conjunction with V.-3:103 (Right to reparation), against the employee's insurer against industrial accidents. Someone who intends to save another person's life does not act for the benefit of that person's life insurance company or employer, etc.

Illustration 25

At one o'clock in the morning G hears a woman's cry for help from a derelict site. He hurries over to it, but before he is able to reach the injured woman within he is struck on the back of the head with a hammer by a maniac. When he comes to, G manages to drag himself out into the street and alert passers-by to the plight of the injured woman (who has likewise been attacked by the maniac with the hammer); the injured woman is then immediately brought to a hospital. G will only have a claim against the woman's health insurer for compensation for the loss of income suffered as a result of his injury (V.-3:103 (Right to reparation)) if the insurer is to be regarded as the principal in accordance with V.-1:102 (Intervention to perform another's duty). It would not follow from V.-1:101 that the insurer is a principal.

Multiple principals. It is, however, possible to act for multiple principals simultaneously. Someone who takes care of another's young child (for example by driving the child to hospital) may act on behalf of both parents; someone who takes care of a house belonging to various co-owners will act for all of them, etc. In their relation to the intervener multiple principals are liable according to the general rules governing solidary liabilities.

D. A reasonable ground (paragraph (1)(a))

General. In the absence of an approval by the principal (cf. paragraph (1) sub-paragraph (b)), the rules on benevolent intervention in another's affairs are applicable only if the intervener has a reasonable ground for taking care of the principal's affairs (paragraph (1)(a)). Whether a party intervening in the affairs of another acts with reasonable grounds must be assessed objectively – from the point of view of a reasonable intervener; a reasonable belief in the existence of a justification for intervention can itself constitute a reasonable ground. What is decisive is whether a reasonable person in the actual situation of the intervener would consider that there was cause for intervening by means of a measure of the type undertaken. Hence a person who takes measures to rescue the principal's property will act with reasonable ground if a reasonable person, placed in the circumstances confronting the intervener, would consider the property to be endangered and that intervention to protect it was necessary, even if (for reasons which the intervener could not know) the property was not in fact at risk.

Defective and deficient performance of the intervention. However, a justified intervention in another's affairs is excluded, if the person intervening makes an irrational assessment as to the existence of a sound reason for acting. On the other hand, someone who does have a reasonable ground for intervention, but merely makes a mistake in carrying out the measures taken, remains a (justified) benevolent intervener. In such a case the intervener has simply breached a duty of care and is answerable for that in accordance with the rules in V.-2:102 (Reparation for breach of duty) but does not forego the status of a benevolent intervener.

Illustration 26

Someone notices that a water pipe in a neighbour's house has burst and (without acting in such a way as to bind the principal directly) engages a plumber to make temporary repairs. If a bad choice of plumber is made, this may constitute a breach of the duty of care, but that does not alter the fact that there was a reasonable ground for intervention. Only in the unlikely event that the commission for the job went to a plumber to whom the neighbour would never have entrusted the repairs, even at the price of considerable water damage in the house, and the intervener knew or ought to have known this, would the required reasonable ground for the intervention fall away because, to the intervener's knowledge, the act of commissioning the objectionable plumber contradicts the wishes of the principal (paragraph (2)(b)). The situation is also different if the water damage threatens to spread to other buildings. In that case the contrary wishes of the principal do not stand in the way of acting as a justified benevolent intervener (V.-1:102 (Intervention to perform another's duty)).

No requirement of pre-existing legal relationship. Since it is one purpose of the law of benevolent intervention in another's affairs to provide an incentive towards socially desirable intervention, there is no call for setting down strict standards to be satisfied when posing the question why this particular intervener undertook the measure (instead of leaving the matter to another). It is not necessary that the intervener and the principal should stand in any close pre-existing legal or personal relationship to one another. In fact, if the latter is the case, the intervener may have had an intention to donate the services and V.-3:104 (Reduction or exclusion of intervener's rights) paragraph (1) may come into play. Equally conceivable are cases in which a reasonable ground for intervention is excluded from the outset because in the circumstances there was no reasonable solution for the difficulty which the intervener sought to eradicate. In that case one is concerned not with a mere defective mode of conducting the intervention, but with the absence of reasonable ground for the intervention. The distinction between the two (which is occasionally difficult and in the last resort must be drawn by the courts in the particular circumstances of the case) will depend on whether a reasonable person would have considered that there was cause for intervention of the sort undertaken by the intervener.

Illustration 27

A stranger in an unfamiliar town sees a window in a building blown in by a strong wind. The building appears to be empty and it looks as if it would be easy to force entry by the front door and temporarily secure the window. The stranger has no reasonable ground for intervening: but should take into account in particular the fact that the owner of the dwelling will not want to have a complete stranger enter the house and damage the door just because such a comparatively minor problem has arisen.

Illustration 28

A fire breaks out in a chemical factory. If a private individual notifies the fire service, that would be to act with reasonable grounds. If, on the other hand, the individual attempts to extinguish the fire personally after the fire brigade has arrived on the scene, that would not be to act with reasonable grounds. If the individual makes an attempt to extinguish the fire before the fire service arrives, it will depend on the circumstances of the case whether there were reasonable grounds. If an enormous blaze has already developed it would be perfectly senseless for a private individual to make any attempt to extinguish the fire. Were the fire to be a small one, however, it could possibly be sensible to tackle it oneself.

A ‘reasonable’ ground. A definition of the concept of “reasonable” can be found in Annex 1. What is “reasonable” is to be objectively ascertained, having regard to the nature and purpose of what is being done, to the circumstances of the case and to any relevant usages and practices.

Some guidance in the following rules. Beyond this general rule, and unaffected by the rule in paragraph (2), the following provisions offer some additional particularised guidance as to when a person acts as an intervener with reasonable ground. In particular, rendering assistance in a case of emergency is (as a rule) regarded as a justified intervention. That emerges automatically from V.–3:103 (Right to reparation), the provisions of which are of direct application only to the right to reparation, but can also be enlisted for another purpose as a concrete illustration of the concept of “reasonable ground”. The Article envisages that the intervener may be “acting to protect the principal, or the principal’s property or interests, against danger”. Equally, it may be, for example, that a reasonable ground for stepping in arises only when the acting party has learned on inquiry that the principal, although obliged to act due to some overriding public interest, nonetheless intends to remain passive: see V.–1:102 (Intervention to perform another’s duty).

E. Want of respect for the principal’s wishes (paragraph (2))

Reasonable ground to act absent. Putting to one side the exceptional situations designated in V.–1:101(1)(b) (approval) and V.–1:102 (overriding public interest), a person does not act as a justified intervener by rashly meddling in the affairs of another. Such is the case when it has been made known to the intermeddler that the interference is against the wishes of the person assisted or the intermeddler could reasonably be expected to know this. This last possibility arises when the intervener could have asked the principal whether the principal was agreeable to the intervention, but failed to pose that question. In such a situation the intermeddler, according to the rules in paragraph (2)(a), acts without a reasonable ground. Should the intermeddler cause legally relevant damage to the other party as a result of the intervention, there may be a non-contractual liability for the damage under Book VI. The same applies if the intervener could not ask the principal but for other reasons knew or should have known that the principal was not inclined to allow such intervention in the matter at hand (paragraph (2) sub-paragraph (b)).

Where the wishes of the principal are not binding. There are, however, exceptional situations in which the intervener acts with reasonable ground, although the principal has made manifest a lack of agreement to an intervention. Leaving to one side those cases in which the principal behaves in bad faith in a way which contradicts what is said (so that the latter does not truly represent the principal’s wishes), one is concerned here as a rule with situations in which the intervener is acting for the benefit of a principal whose wishes an

intervener acting responsibly and with due care would not heed. This is not to be regarded as a case of giving insufficient respect to another's right to free determination of their will. Rather the wishes of persons who by reason of mental disability, the influence of drugs or alcohol, or their minority are unable to express themselves in a way which would carry any weight with a reasonable intervener are not fundamentally opposed to a justified management of another's affairs. That goes for sub-paragraph (a) as much as for sub-paragraph (b) of paragraph (2). The wishes of someone intent on committing suicide are also as a general rule not binding on an intervener – at any rate not when the suicidal intent is the consequence of a psychiatric condition or mental imbalance or some other disturbance of the capacity for self-determination. Where devotees of a particular religious community are fundamentally opposed to blood transfusion on religious grounds, that wish should be respected as a matter of principle. The matter is different, however, as regards their wish as parents to allow their child to die in preference to undergoing a medically warranted blood transfusion. This wish is one which is not to be heeded if the circumstances are such that there is not enough time for taking blood from the child for later use when needed. That is because the wishes of parents to deny their children, for religious reasons, a medical treatment involving a comparatively slim risk to health do not generate an obligation to respect them.

Overriding public interest. A further special situation in which the wishes of the principal are not opposed to a justified benevolent intervention is the subject matter of V.–1:102 (Intervention to perform another's duty). In such a case (as a matter of law) the third party is to be regarded as principal, whether or not the recipient is also principal. See as to this special situation the comments to V.–1:102 (Intervention to perform another's duty) and to V.–2:101 (Duties during intervention) paragraph (1)(b).

Priority of the principal's free determination of will. In all legal systems of the EU the intervener is subject to the duty (regarded as self-evident) to indicate to the principal the business being managed (which business the latter may then take over). This is likewise the fundamental position adopted in these Articles (V.–2:101 (Duties during intervention) paragraph (1)(c)). In contrast to that provision (which is focused on enduring measures undertaken by the intervener), and also in contrast to V.–2:103 (Obligations after intervention) paragraph (1) (which concerns the information provided by the intervener at the conclusion of the intervention) V.–1:101(2) is not concerned with the correct discharge of a benevolent intervention in another's affairs which has been rightfully begun. V.–1:101(2) is concerned instead with the *prerequisites* for commencement of a justified benevolent intervention. Sub-paragraph (a), just like sub-paragraph (b), is an ancillary norm for interpretation of the requirement of 'reasonable ground' contained in V.–1:101(1)(a).

Paragraph (2) sub-paragraph (a). V.–1:101(2)(a) expresses the rule that a person who in the circumstances of the case has a reasonable opportunity of asking the principal whether help is wanted and fails to use it only acts as a justified intervener if the principal later approves the act (paragraph (1) sub-paragraph (b)). For these purposes a reasonable opportunity of contacting the principal suffices. One can imagine a multitude of situations in which the principal would be pleased about the assistance rendered by an intermeddler, but (quite rightly) filled with indignation at not having been contacted despite the fact that it had been possible to do so. In such cases the rights of independence and self-determination deserve priority over the protection provided by a well-meaning, but rashly intermeddling fellow citizen. The requirement for and the possibility of a subsequent approval give due expression to those basic values. Only the approval of the act done creates in such cases the relationship of intervener and principal with its preferential legal position for the intervener

and a legal position for the principal which differs clearly from that of an enriched party under the law of unjustified enrichment.

Illustration 29

One Saturday afternoon, G trims her garden hedge. Out of pure neighbourliness she goes on to cut the hedge belonging to her absent next door neighbour without bothering to ask him for permission. G is not a benevolent intervener.

The intervener is unable to contact the principal. However, it would be wrong to infer from sub-paragraph (a) the converse conclusion that a reasonable ground for intervention will always exist when the intervener is not able to contact the principal. In this instance too it remains of course the case that there must be reasonable cause for intervention by the intervener having regard to all the other circumstances of the case.

Illustration 30

A knows from his friend B that B has always longed to acquire a particular rare (and correspondingly expensive) stamp to augment his collection. While on holiday A suddenly notices that this stamp is on sale and, on the spur of the moment, buys it then and there. A has entered into this transaction at his own risk, even if he had no opportunity to reach B by telephone before deciding whether to buy. That is because an action of this type could have been postponed, or in other words it was unreasonable to act *without a mandate*. Should B have changed his mind in the meantime and accordingly chooses not to approve the purchase (V.-1:101(1)(b)), he is not obliged either to take the stamp off A's hands or to reimburse A for the sum he expended in purchase.

Illustration 31

A's neighbour, N, has failed to pay a telephone bill with due punctuality. That in itself is not a reasonable ground for A to pay the bill in N's stead. However, the matter might be different if the telephone company threatened to disconnect and A knew that N is dependent on maintaining a telephone connection intact. Only in this latter situation does the matter turn on the additional requirement in paragraph (2)(a).

Positive steps required. The benevolent intervener must go so far as to undertake positive steps to discover what the wishes of the principal are or would be if this is something which, according to the wording of the Article, there was "a reasonable opportunity to discover". In view of the modern possibilities of communication (not least, nowadays, the ever increasing availability of mobile telecommunication and electronic mail), the field of application for the law of benevolent intervention has come to occupy a considerably shrunken domain. The easier it is to get in contact with the principal, the lower the probability that a justified benevolent intervention will occur if no attempt to communicate is made.

Reasonable opportunity to discover the principal's wishes. The effort which must be expended in order to ascertain the actual wishes of the principal depends on the circumstances of the particular case. There must be a reasonable relationship between the significance and urgency of the measure on the one hand and the time and cost expended in seeking out the principal on the other hand. Everything turns on a sense of proportion. There are cases in which the measure called for by the situation is so pressing that no time remains even to pose the question; there are also cases in which it would be unreasonable to waste an hour

telephoning the other side of the world in order to obtain permission for effecting provisional repairs; and there are contrasting cases in which one can simply wait.

Contacting the principal can in itself amount to a justified benevolent intervention. The attempt to reach the principal and to solicit a decision (an endeavour which in some circumstances might be very cost intensive in itself) will as a general rule amount to an act capable of constituting benevolent intervention in another's affairs. If it was reasonable in the circumstances to search for the principal (V.-1:101(1)(a)) and if the expenditure sustained in making the attempt is incurred reasonably within the meaning of V.-3:101 (Right to indemnification or reimbursement), then a claim to reimbursement arises, irrespective of whether in the end it proved possible to reach the principal (or, if reached, to get approval). That demonstrates, on the other hand, that as a rule, in the absence of special circumstances, one may not proceed to undertake the substantive act of assistance before making that attempt to obtain the principal's instructions where such an attempt is sensible in the circumstances. Of course an attempt to solicit information which, on a reasonable estimation, would appear at the outset to be pointless need not be commenced (or, as the case may turn out, repeated). That is because the costs of such an attempt would not be incurred reasonably within the meaning of V.-3:101 (Right to indemnification or reimbursement) and no liability on the part of the principal to reimburse would arise.

Benevolent intervention or contract? Whether a contract comes into being between intervener and principal if the principal requests the intervener, in response to the latter's inquiry, to commence (or continue) the undertaking is to be determined in accordance with Book II; it does not need to be decided here. Should a contract be concluded, the rules of benevolent intervention in another's affairs will not of course apply from this point in time because the intervener will be contractually obliged to provide the service (V.-1:103 (Exclusions) sub-paragraph (a)). It is also possible that the terms of the contract might extend to the act carried out (as a benevolent intervention) before the contract was concluded – thus substituting, for example, a contractual right to reimbursement of expenditure for that contained in V.-3:101 (Right to indemnification or reimbursement) in respect of the intervention preceding the conclusion of the contract. Presumably, unless such an agreement can be inferred from the context, something more than a mere request to continue the act would be required in order that the contractual agreement should have such an extensive effect.

Paragraph (2) sub-paragraph (b). Even if the intervener had no reasonable opportunity in the circumstances to contact the principal, the intervener must do what is possible to satisfy the known wishes or probable wishes of the principal. This is the rule contained in paragraph (2) sub-paragraph (b).

Actual knowledge of the contrary wishes of the principal. It follows as a fundamental principle that a person does not act as a justified intervener if the person disregards the known contrary wishes of the principal. Whether or not those wishes are reasonable plays no role. Every person is entitled to live life as they choose within the bounds of what is allowed. One is not obliged to yield to judgements volunteered by others – even if one's own viewpoint is highly eccentric.

Illustration 32

The industrial injuries insurer and the liability insurer fall into a dispute over who will bear responsibility to indemnify in respect of the damage resulting from an accident. There is much in favour of the view that it is a case for a claim under the liability insurance. The industrial injuries insurer therefore demands that payment be made to the entitled injured party. The liability insurer issues a written refusal to do so, insisting (albeit, from the point of view of a neutral observer, somewhat obstinately) that there must be a further scrutiny of the facts of the case. The industrial injuries insurer thereupon pays the injured person. That insurer cannot turn to the liabilities insurer for payment with a claim founded on the notion that they have managed the affairs of the liability insurer. The problem here is one of settlement of liabilities which falls under the law of unjustified enrichment and not the law of benevolent intervention in another's affairs.

Negligent failure to appreciate the principal's wishes. A justified intervention is excluded not only when the intervener positively knows that acting would contradict the wishes of the principal. The benevolent intervener must also contemplate ("can reasonably be expected to know") what might represent the presumed wishes of the principal. The significance of this rule, when set against the background of sub-paragraph (a) (i.e. the obligation to take positive steps to discover the principal's wishes), is perhaps not especially great, but as part of the overall picture is not to be overlooked. When the principal cannot be contacted, the intervener must (still) consider what a reasonable person in the situation would undertake in order to do justice to the principal's wishes.

Standard of care. The standard of care is an objective one (as in the law of non-contractual liability for damage under Book VI). There may admittedly be circumstances, of course, in which a quiet consideration of the matter in hand is made decidedly difficult. The same problem arises when it comes to determining whether an intervener has acted with care (V.–2:101 (Duties during intervention) paragraph (a)) which assumes that there *is* a benevolent intervention in another's affairs and resolves the subordinate question whether the intervener is in breach of duty in the manner of performing. The degree of care required depends on the circumstances; in particular, in emergency cases account must be taken of the fact that the intervener will most likely have had hardly any time for reflection before making a decision. On the other hand, an individual's personal ignorance of matters of general knowledge (which it is legitimate to expect a would-be intervener to know) will not provide an excuse.

Illustration 33

An armed robbery takes place in the foyer of a bank. A customer leaps into action and attempts to disarm the bank robber. In the struggle a shot is fired and the bullet lodges in the customer's knee. The customer has not acted as a justified intervener for the benefit of the bank, because the customer could reasonably be expected to know that the bank would have instructed its employees not to defend its stock of cash at the risk of life and limb.

Acting in ignorance of the principal's wishes, but without negligent failure to heed them. The benevolent intervener does not act without reasonable grounds merely because there is no real consent of the principal to the act. Paragraph (1) proceeds essentially on the basis that a reasonable ground to act is unaffected by the absence of actual consent as such and, indeed, is to be assessed given an absence of actual consent. The purpose of paragraph (2) is to preclude the existence of a reasonable ground where the wishes of the principal are disregarded, not

properly considered or knowingly contradicted. What is decisive is whether the intervener knew, should have known or in the circumstances should have ascertained the principal's contrary wishes. Where the intervener had no reasonable opportunity to inquire as to the principal's wishes, however, and neither knew nor ought to have known that the principal did not want the intervention, the intervener nevertheless acts lawfully if according to the standard of paragraph (1) there was a reasonable ground for intervening. In those (infrequent) cases the principal's wishes, though they are in fact contrary to the act undertaken, do not preclude a justified benevolent intervention. If the principal subsequently disapproves of the intervention, which according to the information obtainable for the intervener at the material time was adequate and reasonable, this retrospective disapproval does not alter the fact that the benevolent intervention is justified. If this were otherwise almost every principal could escape from an obligation to compensate which has already arisen.

F. Approval by the principal (paragraph (1)(b))

Significance and consequences of an approval by the principal. Sub-paragraph (b) of paragraph (1) has the effect that an approval by the principal transforms an originally unreasonable (and therefore unjustified) intervention into a justified benevolent intervention in another's affairs. An approval can be effected by any express or implied unilateral manifestation of an intention on the part of the principal that legal relations with the intervener in respect of the act be governed by the rules of benevolent intervention – in other words, that the legal rights and duties between the parties should be those which would have existed had there been at the outset a reasonable ground for acting. All that is required, therefore, is an indication by the principal of an intention to be bound by the act. The requirement remains, however, that the intervener acted with a view predominantly to benefit another. If this condition is missing the rights and duties of the participants fall to be determined by the law on non-contractual liability for damage under Book VI and the law of unjustified enrichment.

Legal nature of the approval. The approval by the principal is a statement of intention. The rules of Book II apply correspondingly to this manifestation of intention. That is the case in particular in relation to II.–1:106 (Notice).

An important case. An important case, perhaps even the most frequent one, in which the rule on approval applies is the situation in which, before acting, the intervener could have asked the principal and therefore ought to have done so. If the intervener in such a case has in fact acted in a way that accords with the principal's wishes, approval under paragraph (1)(b) at the principal's election is only possible if the intervener has acted with the predominant intention to benefit the principal. The circumstance that the intervener intended to act for the principal's benefit must assume some external manifestation susceptible to proof.

Approval without such undue delay as would adversely affect the intervener. As a matter of principle, approval is not restricted to a precise period of time. It is important only that the principal approves the act without such undue delay as would adversely affect the intervener. The person whom the intervener intended to benefit has the opportunity of deciding whether the intervener had a good ground for intervening. However, that right can only subsist for an indefinite period of time if (i) the principal was satisfied with the act, *and* (ii) approval at the time when it is given would still be to the benefit of the intervener. If the latter is not the case, the right to give approval has expired. It should have been exercised (if at all) promptly, that is to say, without what in the circumstances of the case would amount to

an unreasonable delay. The underlying policy of the rule, in other words, is to protect the intervener from legal uncertainty. The is entitled to know what the position is.

Illustration 34

The facts are the same as in illustration 30. When A offers B the stamp and B refuses to reimburse the purchase price, A is free to sell the stamp to a third party. He is equally free to add it to his own stamp collection, if he has one. B no longer has the (inchoate) right to demand the stamp from A. From this point on, if B changes his mind, B can procure the stamp only on the same basis as any third party – by negotiating for purchase of the stamp a contractual price agreeable to both parties.

Approval and contract. The provisions of this Book are not concerned with whether the approval has contractual effect as between intervener and principal. It might be possible to construe the act of the intervener as an offer (in performance) made to the principal which the principal accepts by approval. Whether that analysis is apt must be determined in the context of particular facts. The question is the same as that which arises in the context of paragraph (2)(a) when an intervener asks the principal what the principal wants. The general rule always applies that if a contract comes into existence between the parties, the rules of the law of benevolent intervention are ousted so far as the contract extends. See V.–1:103 (Exclusions) sub-paragraph (a).

Approval does not, as a rule, create a contract. It is clear at least that in many cases an approval could not create a valid contract. That might be because the intervener, while intending to benefit the principal, lacked the requisite intention to be legally bound when performing the act, and the principal when giving approval may mean to be legally bound but not *by way of contract* (cf. II.–4:102 (How intention is determined)). Equally the intervener may lack the requisite legal capacity to conclude a binding contract. For these reasons some provision within the rules of benevolent intervention itself is necessary as a rule of general application. It does not preclude the possibility that the parties might regulate their relationship by contract and thus displace the default rule that approval effects a retrospective creation of an intervener-principal relationship.

All other requirements of paragraph (1) remain unaffected. All other requirements of paragraph (1) must of course be satisfied in order for approval to create an intervener-principal relationship (see Comment F above). Actions carried out for one's own benefit are only susceptible to approval within the law of representation and not within the law of benevolent intervention in another's affairs. Someone who has acted for another, on the other hand, must accept the risk of being held to that altruistic intention. It follows, therefore, that such a person has to surrender to the benefited party everything acquired due to the benevolent intervention if the principal ratifies the undertaking. If the principal chooses to ratify it, the principal must of course bear the associated burdens.

V.–1:102: Intervention to perform another's duty

Where an intervener acts to perform another person's duty, the performance of which is due and urgently required as a matter of overriding public interest, and the intervener acts with the predominant intention of benefiting the recipient of the performance, the person whose duty the intervener acts to perform is a principal to whom this Book applies.

COMMENTS

A. General

Scope and purpose. V.-1:102 governs a special situation within the law of benevolent intervention. It concerns the discharge of duties owed by another who has neglected them despite the fact that their performance is urgently required as a matter of overriding public interest. “Duty” means something which a person is bound to do: it may or may not be owed to a specific creditor (Annex 1). The term “duty” covers private law obligations but is much wider than that. The provision in V.-1:102 states that, without prejudice to other possible principals (primarily the recipient beneficiaries) the person whose duty is discharged is to be regarded as a principal to whom this Book applies. If the intervener, when acting, intended primarily to promote the interests of the party who owes the duty, the latter’s status as principal may be deduced from the application of V.-1:101; V.-1:102 is neither applicable nor necessary in this situation. The matter rests with the general requirements in V.-1:101. If, by contrast, the intervener acts primarily with the intention of benefiting the immediate recipient of the money paid or services rendered, the person primarily obliged to perform would not be considered a principal under V.-1:101. It is the aim of V.-1:102 to prevent this outcome. The provision to the effect that the third party “is a principal to whom this Book applies” at the same time clarifies that the subsequent rules, i.e. V.-1:103 (Exclusions) and Chapters 2 and 3 apply independently of whether the requirements of V.-1:101 are met. There is therefore no need to determine if the intervener has acted with reasonable ground (V.-1:101(1)(a) in conjunction with (2)). In other words, if the requirements of V.-1:102 are fulfilled, that in itself constitutes a reasonable ground to intervene. It follows that a justified benevolent intervention in relation to such a principal is not excluded merely because that principal (whose default has given rise to the situation) has forbidden intervention.

Duties during intervention. Furthermore, it follows from V.-2:101(1)(b) and (c) (Duties during intervention) that only to a very limited extent must the intervener have regard to the wishes of the principal in the course of the intervention. The benevolent intervener is not constrained by the contrary wishes of the principal – either within the context of whether the benevolent intervener may intervene or in the matter of how the undertaking should be carried out. The constraint of the principal’s wishes is ousted to the extent that an overriding public interest displaces it.

Need for a rule within the framework of benevolent intervention. One question which can be posed is whether the special situations, which form the subject matter for V.-1:102, should not be taken out of the law of benevolent intervention and addressed in the law of unjustified enrichment instead. The answer is certainly not merely a matter of the aesthetics of codification. Quite apart from the consideration that the approach adopted here corresponds to the traditions of the civil law systems, this approach is supported by the notion that in this situation too the intervener ought to benefit from the privileges granted by the law of benevolent intervention. Numbering among those in particular is the point that (in contrast with the law of unjustified enrichment) the intervener’s claim turns only on the prospective usefulness assessed at the time the act was commenced; it is not decisive that as a result of the intervener’s act the principal was actually saved expenditure and consequently enriched. Moreover, with the assistance of the approach chosen here, it is clear from the outset that the intervener acts lawfully within the meaning of the law on non-contractual liability for damage

caused to another. The situations covered will not infrequently involve acts of intervention for which V.-3:103 (Right to reparation) is material.

B. Intervention Urgently Required in Overriding Public Interest

Overriding public interest. The contrary wishes of the principal need not be heeded if the principal is not discharging a duty, the performance of which is due and urgently required as a matter of overriding public interest. This rule requires not merely that the intervener acts to discharge a duty of the principal, but also that the discharge of the duty is of overriding public interest. It relates to the discharge of duties which are founded in a private law context, but are of such importance that their fulfilment is at the same time a matter of public interest. The question as to which circumstances generate an overriding public interest cannot be answered once and for all and perhaps the answer may not even be the same for all European jurisdictions. (The public attitude towards suicide, which differs from country to country, may serve as an example.) A minimum requirement for a public interest, however, is that the discharge of the duty is not merely in the interest of a single person. The typical cases concern duties, based in the law on non-contractual liability for damage, to secure safety at large, whereas the performance of contractual obligations will hardly ever be a matter of public interest.

Performing another's maintenance obligations. The performance of obligations to maintain persons who are not being maintained by the relevant maintenance debtor also falls under V.-1:102. For present purposes, such obligations of maintenance are not to be understood as confined to furtherance of a private interest only, at any rate so long and in so far as the social policy of the state follows the principle of subsidiarity. That is because an elementary public interest is contained within the advancement of a privately maintained community and the contingent relief of the public purse which that entails. A comparable case since time immemorial is the arrangement of a burial.

Performance must be due. Performance of the neglected duty must of course be due. It will not suffice that a duty whose performance will become due at some future point of time will most likely not be discharged. An imminently dangerous situation must already subsist at the moment of intervention. The requirement that performance of the duty is due is otherwise not of particular importance since the discharge of a duty where performance is not yet due will hardly ever be a matter of overriding public interest.

Performance must be urgently required. Not every duty that satisfies the requirement that its discharge is of overriding public interest may be enforced by a third party against the contrary wishes of the debtor. Performance must be urgently required. There must be a need for immediate action, which will as a rule consist of a provisional measure to ensure safety. Examples would be measures taken to safeguard dangerous spots for other road users, or to extinguish a fire or remove the risk of water damage which threatens to encroach on to neighbouring premises. Further examples would be taking measures (which cannot be postponed) to prevent an environmental damage which is immediately threatening to occur.

Illustration 1

P has parked a car in front of the emergency access for the fire service at a student halls of residence. I notices that the halls of residence have caught fire. I may remove the car despite the protest of P, if the removal is necessary in order not to delay the efforts of the fire brigade which is already on its way. If, by contrast, there are no signs

that the building has caught fire and the obstruction of the emergency access by P's car presents a merely notional danger for the building and its residents, then the removal of the car, although in the public interest, does not require I to intervene personally. It would be sufficient to call the police

Illustration 2

A society for the prevention of cruelty to animals attends to a maltreated and injured pet lying in agony in the street. The owner may not counter a claim for compensation for the costs incurred by the society with the objection that she had informed the association that she did not consent to the emergency treatment. That would entail cruelty to the animal of a criminal nature.

Illustration 3

A warehouse, which P has rented from I in order to store large quantities of milk powder, catches fire. The warehouse is destroyed. Some of the milk powder has burned; the rest of it has mixed with the water from the fire fighting and threatens to pollute the ground water. The competent public authority instructs I to clean up the ground and remove the remains of the milk powder. I does not have to heed the contrary wishes of P, whose lease has terminated. I can claim compensation in respect of the costs incurred for the sum which P would in any case have had to bear in the case of a normal termination of the lease. The removal of the remaining milk powder was a matter of overriding public interest. The claim for compensation is not blocked by V.-1:103 (Exclusions), sub-paragraph (c), since the "obligation to a third party to act" referred to in that Article only extends to an obligation arising from a private law legal relationship (whereas I's duty to follow the instructions of the public authority is a duty under public law).

C. Third party to be regarded as principal

An exception to V.-1:101(1). The rule in V.-1:102 specifies that the third party who has not fulfilled the duty is to be regarded as a principal. This clarification is necessary because V.-1:101(1) looks to the direction in which the subjective aspiration of the intervener points and often (though, of course, not necessarily) the intervener will have the individual whose body or property is in fact being protected from danger exclusively or at any rate predominantly in mind. However, the person who is responsible in law for the situation of danger should not be relieved from that responsibility. It follows, therefore, that in such a case that person too is to be regarded as a principal and that must be so even though the person that the benevolent intervener predominantly intended to benefit was the beneficiary of the performance of the principal's duty. In other words, it must be decided from case to case on the basis of V.-1:101(1) whether the beneficiary is to be recognised as a principal too. V.-1:102, on the other hand, stipulates the general rule that in any case the person under the duty to act is "a" principal (albeit not necessarily "the", i.e. the sole, principal). This applies even if the benevolent intervener never even thought of seeking to protect that person from possible liability. On the other hand, it remains the case in situations of this type that the benevolent intervener must have intended to benefit *another* (as recipient of the performance). Just as with the basic situation covered by V.-1:101, there can be no benevolent intervention in these circumstances if the intervener discharges a duty of the principal which was owed to the intervener, intending thereby to benefit himself or herself.

Illustration 4

The facts are the same as in Illustration 25 to V.–1:101. The woman’s health insurer established under public law is also regarded as a principal. The duty of such a health insurer to provide medical treatment is a matter of public interest.

Illustration 5

A woman, who is separated from her husband but dependent on maintenance payments received from him, has an adipoma removed from her back by a doctor. Prior to the operation her husband states that he will not cover the costs of the operation. If the woman cannot obtain her husband’s financial support for the operation under the applicable provisions of family law, she will not be able to do so by virtue of the rules on benevolent intervention either, since the surgery performed is not of urgent necessity. The doctor therefore only has a claim against the woman, who is exclusively liable.

D. V.–1:101(2) inapplicable

Public interest overriding the contrary wishes of the principal. For cases which satisfy V.–1:102, V.–1:101(2) can have no application. We are concerned here with situations in which an overriding public interest has priority over the otherwise constraining wishes of the principal. Often the situation will amount to precisely the opposite of a conventional benevolent intervention; if the benevolent intervener has learned that the principal intends to default on the relevant duties, the benevolent intervener has a reasonable ground for intervention.

Illustration 6

A toddler is badly injured by a car accident and is taken to a hospital in a state of unconsciousness. The doctor in charge is able to contact the parents by telephone, but the parents object to the emergency operation for religious reasons. There is no time to apply to a court. The emergency operation may be conducted despite the contrary wishes of the parents.

V.–1:103: Exclusions

This Book does not apply where the intervener:

- (a) is authorised to act under a contractual or other obligation to the principal;*
- (b) is authorised, other than under this Book, to act independently of the principal’s consent; or*
- (c) is under an obligation to a third party to act.*

COMMENTS

A. The negative requirements for the applicability of the law of benevolent intervention

Fundamentals. The provisions of V.–1:103 concern cases in which the law of benevolent intervention is not applicable, despite the fact that the conditions of V.–1:101 (Intervention to benefit another) or V.–1:102 (Intervention to perform another’s duty) are satisfied. V.–1:103 therefore touches upon the ‘negative’ requirements of a benevolent intervention, namely (a) the absence of an authorisation (and obligation) to act arising out of some contract or other legal ground, (b) the absence of a power to intervene which is independent of the wishes of the principal, and (c) the absence of an obligation to act owed to a third party.

Priority of special statutory regimes. The Article does not expressly state that the law of benevolent intervention also yields priority to special statutory regimes which aim to provide a complete set of rules for the cases covered. That does not seem necessary because it is merely an instance of the general principle whereby in case of conflict more specialised statutory provisions oust the application of general provisions. Consequently, where the law provides for special and exhaustive rules governing the relationship between the intervener and the principal, those special rules have precedence over the rules in this text. Examples are to be found in statutes on the provision of emergency aid by doctors.

B. Authority and obligation (sub-paragraph (a))

The principle. A person who is obliged to the principal to undertake the act in question does not act as an *intervener without authority*. This is a defining feature of this area of law, whose purpose is precisely to bridge the gap which may arise from the absence of a pre-existent obligation under private law – in particular the absence of a contractual obligation to act. Moreover, someone who is obliged to the benefited party to undertake the act in question is necessarily at the same time also authorised to act. That is the point of departure for the formulation adopted for sub-paragraph (a) and is true both for contractual obligations and obligations imposed by law on the active party in favour of the benefited party. The authority to act derives its foundation from the particular obligation whose performance falls for consideration. Someone who is obliged to the principal to act is always also authorised to act (though conversely not everyone who is authorised to act is also obliged to act: see sub-paragraph (b)).

Precise identification of the obligation. It is important, however, to identify the relevant obligation precisely in the context of the particular case.

Illustration 1

A plumber who has been summoned by a home owner to repair the plumbing, but is not greeted by the owner on arrival at the house proceeds to repair the plumbing anyway. The plumber was obliged to make the repairs, but not authorised to enter the house without consent (unless the parties had agreed this). The apparent contradiction is resolved when it is accepted that the plumber was not obliged to convert the promise into action *in this way*. So considered it remains the case that one who is obliged to do an act is always also authorised to do it, while one who is authorised to do it is not thereby automatically obliged to do it.

Acting under a contractual obligation towards the principal. A benevolent intervention can only be made out if the parties do not stand in a legal relationship which confers on the intervener a right to conduct the affairs of the principal which are in fact managed. In particular, there is no benevolent intervention, therefore, if the party acting was contractually obliged to the entitled party to undertake the act in question. Whether a contract between the parties has come into existence and, if so, what rights and obligations it establishes between them are questions which are exclusively for determination in the law of contract. Contract law thus has complete priority to this extent in relation to the law of benevolent intervention. The latter comes into play only if the necessary contractual authority to act and a corresponding contractual obligation cannot be found. In that case there remains room for the law of benevolent intervention to operate between the parties.

Illustration 2

Where a party to a long-term contract suffers a heart attack during a business negotiation about termination of the contractual relationship and is brought to hospital by the other party, the latter acts as a benevolent intervener in doing so. Ferrying the contractual partner to the hospital has nothing to do with the contractual relationship between the parties.

Existence of a contract. The Article leaves to the law of contract all questions as to the existence of a contract and the rights and obligations which arise out of it. It is for contract law to decide whether and in what circumstances a contract has come into existence between an intervener and a principal by which the former obtains the consent of the principal to intervene or, as the case may be, continue the intervention. The Article equally leaves it to contract law to decide whether an approval of an intervention (V.-1:101(1)(b)) leads in any given case to the conclusion of a contract (see Comment F to V.-1:101). Moreover, under the rules on benevolent intervention in another's affairs it is for the law of contract to determine whether and in what cases a contract comes into existence where someone intervenes at the request of another or in response to another's cry for help. V.-1:103(a) is accordingly silent on the particular issue of what conditions are necessary for a contractual obligation to provide aid or the assumption of a contractual obligation to pay damages in favour of a rescuer (a *convention d'assistance*). Presumably, under Book II, as a rule, no contract to provide assistance or to pay damages comes into being between the injured party and the rescuer, since neither the rescuer nor the party calling for help will normally have the intention to bind themselves legally. Thus in such cases room is left for the application of the law of benevolent intervention. The same goes for courtesies and favours which do not involve a legal obligation. However in case of such arrangements (such as for example being given a lift in another's car) it will often be assumed that the active party acts with an intention of conferring a gratuitous benefit V.-3:104 (Reduction or exclusion of intervener's rights) paragraph (1). A contractual relationship does come into existence, however, if someone promises another a reward for doing something specific; it is concluded at the moment that the promisee commences performance of that activity. Finally, so long as there is no European regime to determine under what circumstances a (valid and enforceable) contract is concluded with a person who lacks full legal capacity (e.g. a minor) this area too remains to be governed exclusively by the applicable law of contract or law of persons, as the case may be. In this context it may be that by virtue of a special statutory regime the relationship between doctor or hospital on the one hand and an unconscious patient on the other is configured on a contractual basis.

Acting in pursuance of a void contract. V.-1:103 does not touch upon the question whether a person who performs under a contract for services, supposing there is an obligation to do so, may qualify as an intervener if the contract turns out to be void. This question falls to be decided instead under V.-1:101 (Intervention to benefit another) and must be answered in the negative due to the absence of an intention to benefit another (see Comment C under V.-1:101).

Acting in breach of contract. There is equally no intervention without authority where a party to a contract acts in that capacity but not in conformity with the contract. The fact that a party to the contract performs the obligations under the contract poorly does not alter the fact that there was authority to intervene.

The priority of functionally similar contract law rules. The law of contract contains various rules which from a functional point of view show certain similarities to the law of benevolent intervention. These rules too, of course, have priority and thus correspondingly exclude the law of benevolent intervention. A case is provided by the obligation of a debtor whose creditor is in delay in accepting performance to safeguard or accept the subject matter of the performance (e. g. goods sold) in the interests of (but also at the expense of) the creditor (cf. III.–2:111 (Property not accepted)). Another example can be found in the extended rule of the law of mandate whereby in a case of unforeseen events the agent may depart from the instructions which have been given and, after a vain attempt to contact the principal, may make a decision in the principal’s interest. Where such a power arises out of contract law rules governing the relationship between the parties, the agent does not act as intervener. That is the case independently of whether the agent is also *bound* to deviate from the original instructions (i.e. to do what a reasonable agent would do to safeguard the principal’s interest) (in which case V.–1:103(a) would apply); even if the applicable contract law regime merely authorises the agent to deviate from the principal’s declared wishes, the intervener is entitled to act despite the absence of the principal’s consent (V.–1:103(b)). Where, on the other hand, under the applicable contractual regime such a power founded on the law of contract is absent, then that very same act without more may constitute a benevolent intervention. A conceivable case in point would be an agent who feels compelled by a sudden and exceptional course of events in attending to the interests of the principal to exceed a price limit set by the principal for good reason. If the applicable contract law does not contain its own rule for this situation, then the law of benevolent intervention applies (and the converse is also true). As regards the substantive result in cases of this type, however, it will not make any difference whether they are resolved on the basis of the law of contract or the law of benevolent intervention in another’s affairs.

Acting under another obligation towards the principal. The performance of a contractual obligation is only one case among many (albeit a particularly important one) in which there is no benevolent intervention because vis-à-vis the principal the party acting *must* do so as a matter of private law, is correspondingly authorised to act and consequently is not dependent on the law of benevolent intervention for a justification for his acting. The Article does not employ the criterion of the “voluntariness” of the act, which can be found in Romance legal systems. That has been done, however, primarily for technical reasons and not on account of any legal policy consideration. The criterion of “voluntariness” appears both on the one hand too imprecise and on the other hand too narrow. What should be decisive instead is whether the party acting was under an obligation towards the principal. However, the matter does not turn on the source (statutory or contractual) of the obligation. Those who perform their statutory obligation to maintain their children, their spouse or their parents do not act as benevolent interveners any more than those who perform the obligation under the law of unjustified enrichment to return something in their possession or ownership. The performance of an obligation arising, for example, from the initiation of expectations of a concluded contract (“*culpa in contrahendo*”), cf. II.–3:302 (Breach of confidentiality) or in consequence of causing legally relevant damage to another is likewise not an incidence of benevolent intervention.

Illustration 3

A person does not act as a benevolent intervener when remedying damage for which that person is responsible, such as damage to ground water caused by trying to refill an underground oil tank which in fact no longer exists.

Moral obligations. Only legal obligations are relevant here; the discharge of a moral obligation will not suffice to exclude the application of the law of benevolent intervention in another's affairs.

The duty to render assistance under criminal law. Many European legal systems contain a rule which renders a person liable to criminal sanctions when he or she sees a fellow human being in substantial peril to life or limb and fails to render assistance despite the fact that it would have been possible to do so without having to subordinate any significant interests (a criminal omission to render assistance). In some cases particular professional groups (especially doctors, but in given circumstances also vets too, for example) are subject to wide-ranging duties to help and must reckon with the possibility of criminal punishment should they fail to fulfil them. Those who act under the threat of punishment if they do not help may well not act "voluntarily", but there should be no doubt that such persons are afforded the (privileged) legal position of benevolent interveners. The threat of punishment is meant to provide only a *further* 'incentive' for taking action; it should not have the counter-productive effect that interveners are stripped of legal protection available under private law. In these rules, therefore, it matters only whether the intervener is authorised to act under a private law obligation *owed to the person assisted*. It is precisely that requirement which is not in fact satisfied in the case of acts taken under the impulse provided by a threat of punishment by criminal law. That is because in the first place such duties exist for the general public interest; they do not provide even a theoretical platform for a claim based in private law and, according to the overwhelmingly predominant European legal viewpoint, their breach does not found a claim for compensation for the person who was not assisted. Even if one were to take a different view (i.e. regard a claim to reparation as well-founded), the circumstance that (at least theoretically) the assisted person could at any time refuse assistance as an unwanted interference shows that the person giving assistance is in fact a benevolent intervener. The duty to render assistance imposed by the criminal law does not provide the helper with authority to intervene which is independent of the principal's will. Correspondingly the duty to act does not exist, or ceases to exist, when the principal rejects assistance as unwanted.

C. Acting under another authority (sub-paragraph (b))

General. The second of the "negative" conditions for a justified benevolent intervention in another's affairs is the requirement that the acting party must not be authorised in relation to the benefited party to do the act in question independently of the latter's consent. This is the case where the authority to act stems from rules outside the law of benevolent intervention. Where there are such special grounds justifying intervention, there will also be as a rule an independent – and in a case of doubt exhaustive – legal regime for the regulation of the rights of the participants. That in itself, however, is not the decisive consideration; what matters is whether either the person acting is entitled to act against the wishes of the person affected or, as the case may be, the person acting is the one who generates the affected person's legally binding will. In either case one is concerned with an authorisation for a person to interfere in the legal position of another; that circumstance precludes a benevolent intervention relationship from arising between them.

Examples in private law. Examples include a guardian in relation to a ward, parents in relation to their children, or the governing organs within a legal person in relation to the legal person itself. In relation to particular acts undertaken these persons will often also fall under the rule in sub-paragraph (a); that is the case when they are fulfilling their existing (statutory) obligations in relation to the other person. However, even when that is not the case, by virtue of sub-paragraph (b) they still do not act in relation to that person as interveners. Furthermore,

a neighbour who is granted power by property law rules to lop overhanging branches encroaching from neighbouring land or to clean shared drains against the wishes of a co-owner does not act as a benevolent intervener. The same holds where a tenant exercises a power under the tenancy agreement to carry out necessary repairs at the landlord's expense and without the landlord's consent in the particularly pressing circumstances envisaged by the contract.

Authority to act under public law. The situation is similar where someone is entitled to intervene under public law (a public fire service, the police etc.). The intervention of such services for the maintenance of public safety and order is referable to a special legal basis; it does not constitute a benevolent intervention in another's affairs. As a general point and for the avoidance of misunderstanding, it should be reiterated here that the draft only engages with questions of private law and does not address problems of reimbursement of costs or any other similar issue arising from the exercise of powers under public law. The power of an authority to intervene is of course an essential feature in the make up of a state or public prerogative.

Illustration 4

Other road users are obliged to stop when instructed to do so by a school crossing patrol; the patrol does not act as a benevolent intervener in relation to the children or the other road users.

Illustration 5

While a cattle truck is being unloaded a bull breaks free and escapes on to a dual carriageway, where it is shot by a police officer. The officer suffers trauma as a result of the blast. This does not confer a right to compensation from the cattle dealer under V.-3:103 (Right to reparation) in conjunction with V.-1:102 (Intervention to perform another's duty); the officer was authorised under public law – independently of the cattle-dealer's consent – to shoot the animal in order to protect road users from the danger.

Illustration 6

On the other hand, someone who at the invitation of the revenue service informs on tax dodgers in return for a 'bounty' acts without special authority in making investigations and passing on details to the tax authorities. The informer acts outside the field of public law and is not a benevolent intervener (and thus cannot recover costs from the tax authorities) only because acting predominantly in pursuit of his or her own interests – namely for the purpose of earning the reward on offer.

“Independently of the principal's consent”. As already mentioned, there is no benevolent intervention if the party acting does not depend on the consent of the principal for intervention in the principal's affairs and instead acts by virtue of his or her own authority. An express consent of the principal, on the other hand, excludes the application of the rules on benevolent intervention only if as a result a contract is concluded between the intervener and the principal (see Comment B above). Taken by itself, the consent of the principal does not constitute an authorisation because it can be revoked at any time prior to carrying out the measure in question. Moreover, no other outcome would be possible here because the whole idea of benevolent intervention is to protect the active party who is entitled to set forth to comply with the assumed wishes of the other party. If those wishes are in fact complied with, that is obviously no reason to *deny* a benevolent intervention in that other's affairs.

Illustration 7

Following a road accident abroad, the holder of a third party insurance policy is arrested. At the insured person's pressing request the insurance company puts up the bail, although both parties know that according to the contract of insurance it is not obliged to do so. It is also clear to both sides that the insurance company has provided this additional service as a goodwill gesture. The insurance company acts as a benevolent intervener. It would not be correct to seek to deny the company that status on the basis that it had been "authorised to act". The insurance company's authority depends solely on the principal's consent.

D. Performing an obligation towards a third party (sub-paragraph (c))

Significance. Someone who by intervening performs an obligation imposed under private law does not act as intervener even if the other requirements of paragraph (1) are satisfied. In practice, however, it will seldom be the case that an intervention fails to qualify as a benevolent intervention for this reason alone. The intervention will often be excluded from the law of benevolent intervention due to the basic requirements of V.-1:101, e. g. because performances which are rendered for the purpose of performing a (real or imagined) obligation are normally not undertaken with the intention *predominantly* of benefiting another. In particular, it follows from this that those who mistakenly assume that in acting they are performing a contractual obligation do not come under the regime of benevolent intervention in another's affairs; they must seek recompense instead within the law of unjustified enrichment.

Scope of application. Even if the requirements of V.-1:101 are met as between the intervener and the benefited party, where the intervener is obliged to a third party to undertake the act done (the typical case involving a contractual obligation) the intervener is not to be regarded as a benevolent intervener in relation to the party benefited. In such cases there is neither need nor sufficient ground for the creation of an intervener-principal relationship: the party acting (the 'intervener') is entitled only to look to the relationship with the contractual partner. A frequent case is where someone is commissioned to undertake repairs for the benefited party. (It is immaterial in that respect whether or not the person commissioning the repairs acts as a benevolent intervener in relation to the party benefited). In such situations it is occasionally the case that the person commissioned acts in relation to the party benefited with the intention of furthering the latter's interests – when (among other things) the contract is not the motive for intervening. It is the purpose of sub-paragraph (c) to clarify that in those instances too there is no benevolent intervention.

Illustration 8

R is commissioned by a landlord L to carry out repairs in the apartment let to the tenant T and carries these out. L is not a benevolent intervener in relation to T because L acts in relation to T in discharge of L's obligations as landlord and is thus authorised to act. R in turn is also not a benevolent intervener, either in relation to L because of the priority of the law of contract or in relation to T because of sub-paragraph (c). The latter provision is necessary for the case where R acts under contract to L, but would have been willing to intervene even if not commissioned by L (e. g. because R and T are neighbours on very good terms) and thus acted all along with a predominant intention to benefit T. (If, depending on the application of the rules on stipulations in favour of third parties (see II.-9:301(1) (Basic rules)), L and R concluded a contract for T's benefit, then R is no benevolent intervener in relation to T because of V.-

1:103(b)). If R carries out the repairs badly, R is liable under the contract to L (and, as the case may be, to T); but there is no liability to either L or T under the law of benevolent intervention.

Illustration 9

A charitable organisation concludes a contract with a public authority whereby the charity is obliged to carry out certain rescue services for which the public authority, for its part, carries the cost. The charitable organisation in performing these services does not act as a benevolent intervener in relation to the persons rescued.

Demarcation. One should not confuse with this situation cases in which a benevolent intervener performs obligations incurred as a representative acting for the principal in benevolent intervention.

Illustration 10

The facts are the same as in Illustration 8, except that L is not the landlord of T but rather another friend of T who commissions R to deal with a broken pipe in T's apartment. L's act of commissioning R is in this case a benevolent intervention by L in T's affairs. The payment of R's bill by L remains a benevolent intervention in relation to T, unaffected by the circumstance that L is contractually under an obligation to R to pay: that obligation is merely the consequence of the intervention undertaken by L. It is not merely that L has a claim against T for reimbursement of expenditure. It is also the case that (so far as this is reasonable in the circumstances) L must inform T that the debt to R will become due and give T the chance to pay R directly.

Precise analysis of the contractual obligation. What matters is whether the person acting is contractually obliged to a third party in regard to the activity undertaken. Such cases may call for close scrutiny of the contract between the person acting and the third party in order to determine whether the actor is or is not actually under an obligation to perform the act which benefits another.

Illustration 11

A ship's doctor attends to a suffering passenger who has lost consciousness. If the doctor has undertaken to the shipping company to provide medical services to passengers (most probably in return for a fee), then it is not the doctor but rather the shipping company, with its employment of or arrangement with the doctor, which acts as benevolent intervener in relation to the patient. (This is assuming that the situation ought not rather to be analysed on the basis that the company for its part is merely discharging a contractual obligation to the passenger – in which case, there would be no benevolent intervener at all.) On the other hand, if the doctor has merely agreed to be “on call” (e. g. because the shipping company merely wished to preclude any potential non-contractual liability to a passenger which might result if the passenger fell ill and no medical assistance was available on board ship), the doctor performs his or her contractual obligation by being on the ship and accessible to those in medical need. Actual provision of medical treatment to any particular passenger who needs the doctor's assistance will exceed the doctor's contractual obligation to the shipping company.

No limitation to contractual obligations. The provision in sub-paragraph (c), however, is not limited to the discharge of *contractual* obligations incurred to third parties. It will also

cover the performance of subsisting obligations to third parties arising under statute or by operation of law. V.-1:103(c), however, does not touch upon acts which are conducted in discharge of a duty under public law.

Illustration 12

A married person who complies with a subsisting statutory obligation *owed to the other spouse* to contribute to the maintenance of stepchildren (i.e. to the spouse's children living in the same household) is not a benevolent intervener in relation to the children in making that contribution.

Illustration 13

I and P are co-owners of a joint gable wall which is in danger of collapsing. A supervisory authority for buildings orders I to pull down the wall on grounds of public safety. I may claim from P a proportionate contribution in respect of the costs: P cannot veto the demolition of the wall due to V.-1:102, and I does not act in compliance with an obligation to a third party arising under private law.

CHAPTER 2: DUTIES OF INTERVENER

V.-2:101: Duties during intervention

(1) During the intervention, the intervener must:

(a) act with reasonable care;

(b) except in relation to a principal within V.-1:102 (Intervention to perform another's duty), act in a manner which the intervener knows or can reasonably be expected to assume accords with the principal's wishes; and

(c) so far as possible and reasonable, inform the principal about the intervention and seek the principal's consent to further acts.

(2) The intervention may not be discontinued without good reason.

COMMENTS

A. The duties of the intervener in overview

Duties and obligations. The provisions of the second Chapter of these rules relate to the duties of the intervener to the principal. The subsequent Articles differentiate between the actual phase of intervention (V.-2:101 and V.-2:102) and the period after the conclusion of the intervention (V.-2:103). The word "Duties" in the Chapter heading covers both sets of duties. However, there is a distinction between them. In the first phase the duties are only duties and not obligations. In the second phase the duties are not only duties but also obligations. The difference in the present context lies in the remedies for breach. Remedies for breach of the duties during interventions do not arise unless damage occurs; they are then regulated by V.-2:102 (Reparation for damage caused by breach of duty). The reason for this is that it would be harsh to impose, for example, an *obligation* of care on a benevolent intervener and to thereby attract all the remedies for non-performance of an obligation, such as the remedy of enforcing specific performance. A person who has been good enough to intervene in the interests of another but who has not come up to the required standard of care, or who has not done the job as the principal would have wished it to be done, should not, for example, be liable to be forced to do the job again and to do it better the second time. In this

situation a mere duty to take care and to act in accordance with the principal's known or assumed wishes, coupled with a carefully tailored liability to make reparation if breach of the duty causes damage, is quite sufficient. On the other hand, once a benevolent intervention has taken place, it is not unreasonable to impose an enforceable *obligation* on the intervener to account and to hand over any benefits obtained, particularly if the remedies for non-performance are slightly modified to take account of the benevolent nature of the intervention (as is done by V.–103 (Obligations after intervention) paragraph (3)).

Duties during intervention. During the intervention a benevolent intervener (i) is subject to a general duty to act with reasonable care; (ii) must orientate the intervention according to the actual or presumed wishes of the principal; and (iii) is subject to a parallel duty to inform the principal of the intervention and seek the principal's consent to further acts (paragraph (1) (a), (b) and (c) respectively). The last of these duties implies that as soon as the intervener has succeeded in contacting the principal the intervention may be continued only if the principal consents. On the other hand the intervener may not (iv) discontinue the intervention without a reasonable ground. The intervener, in other words, may not discontinue at an inopportune time an intervention which has already begun (paragraph (2)). If breach of one of these duties causes damage then, in certain circumstances, the intervener is liable for reparation but the benevolent nature of the intervention is taken into account in the rules on the assessment of this liability. The intervener may not be burdened with the entire risk of erroneous conduct during the intervention (IV.–2:102 (Reparation for damage caused by breach of duty)).

Obligations after intervention. After conclusion of the act undertaken the benevolent intervener is subject to an obligation (v) to report, (vi) to account and (vii) to deliver up any proceeds (V.–2:103 (Obligations after intervention) paragraph (1)). The normal remedies for non-performance of an obligation apply but the fact that the intervener has acted for reasons of human solidarity will have to be taken into account (V.–2:103 (2) and (3)).

The second Chapter's scope of application. The second Chapter concerns the duties of the acting party in the phase of carrying out the intervention. It regulates the matter of 'how' another's affairs may be managed without their authority and how this management must be brought to an end, as opposed to 'whether' they may be conducted, which is addressed in V.–1:101 (Intervention to benefit another) and V.–1:102 (Intervention to perform another's duty). The application of V.–2:101–V.–2:103 thus presupposes that the requirements of V.–1:101–V.–1:102 are satisfied and that none of the exclusions of V.–1:103 applies. If one of these requirements is absent or an exclusion applies, then the rights and duties of the parties will be governed exclusively by other areas of the law – in particular, the laws of contract, non-contractual liability for damage and unjustified enrichment.

Illustration 1

The facts are the same as in Illustration 9 of V.–1:103. A staff member of a charitable organisation giving emergency aid to an injured person makes a clinical error. Any liability of the organisation will be under the provisions of the law on non-contractual liability for damage in Book VI. There is no scope for the application of V.–2:103 (Reparation for damage caused by breach of duty) paragraph (2).

B. The general duty to act with reasonable care (paragraph (1)(a))

General. Interventions for the benefit of another are only useful as a rule if the intervener acts with reasonable care. A person who instructs a joiner to effect an emergency repair in a

neighbour's house will have to choose a qualified joiner; a person who attends to a person injured in a traffic accident will have to secure the scene of the accident and in bringing the person to hospital will have to comply with the traffic regulations, etc. The requirements which reasonable care dictates are as manifold as life itself and thus cannot be elaborated in detail. As regards the management of affairs which interfere with interests protected by the law on non-contractual liability for damage recourse may be had to the definition of negligence in VI.-3:102 (Negligence). In accordance with that a definition an intervener may breach the duty of care by omitting to take a precautionary measure. This may occur for instance if the intervener takes valuable goods into custody but fails to take out insurance cover.

Standard of care of professionals. Conduct of a benevolent intervener who is acting in the course of a profession or trade is to be assessed against the standards of care expected of persons in that skilled group. That is in a way merely the flip side of the coin under V.-3:102 (Right to remuneration), which entitles a professional to remuneration. Compare in this context also the Comments to II.-9:108 (Quality), which deals with the quality to be expected under a contract in general in the absence of contractual regulation, and IV.C.-2:105 (Obligation of skill and care) paragraph (3), which deals with the standard of care of professionals in service contracts.

Emergency measures. These rules do not set out a specific standard of care applicable to emergency measures. For one thing, it did not seem necessary to do so. The general principles of the law of negligence lead to the result that, in determining whether the intervener is in breach of the duty to act with reasonable care in the course of acting, regard is to be had to the difficulty in judging a situation of danger and in endeavouring to eliminate it. The text of this Article refrains from spelling out this principle only because it is assumed to be self-evident. Moreover, the situations concerned also require a distinction with regard to the applicable standard of care – for instance, between a professional rescuer and a private individual. Emergency (para)medics, sea rescue services and other comparable professional groups and organisations should be capable, even in serious cases, of exercising a greater degree of composure in decision-making in the stress of an emergency, as is expected of their profession and acquired through training. On the other hand the drafting of a specific standard of care for emergency situations also appeared to be dispensable in view of the reduction clause in V.-2:103(2). Under the latter the intervener's liability is reduced or excluded in so far as this is fair and reasonable, having regard to, among other things, the intervener's reasons for acting. This rule will be of great relevance in particular in cases of measures taken in an emergency.

C. Compliance with the principal's wishes (sub-paragraph (b))

Specification of the general duty of care. The law of benevolent intervention has on the one hand the task of protecting the activities of persons who are active for another's benefit, but on the other hand it must check rash acts of intervention. Someone who voluntarily undertakes to look after the interests of other people must do so with care; a person who is not prepared to do so ought to stay out of the matter altogether. However, paragraph (1) does not merely contain the general duty of care (sub-paragraph (a)); it also specifies that duty from the point of view of benevolent intervention. As part of the benevolent intervener's duties of care, the intervener must comply so far as possible with the wishes of the principal in the carrying out of the duties (just as much as in determining under V.-1:101(2) (Intervention to benefit another) whether there is at the outset a reasonable ground to act as a benevolent intervener at all). Only if those wishes are neither known nor ascertainable must the benevolent intervener

take for orientation what, objectively understood, the principal could reasonably be assumed to wish.

Special information available to the intervener. The touchstone for the duty of care in such cases is therefore the wishes of a principal who takes reasonable care of his or her rights and interests. That is because the wishes of the principal can take priority only in so far as they were known by the intervener or, if such care as was reasonable in the circumstances had been exercised, would have been known by the intervener. Should the intervener have special information available which sheds light on the wishes of the principal, then the intervener must make use of that information.

The exception in V.-1:102. Compliance with the contrary wishes of the principal is not obligatory if the principal is opposed to the performance of a duty owed to a third party when performance is due and urgently required as a matter of overriding public interest (V.-1:102 (Intervention to perform another's duty)). The same consideration which applies in relation to taking on the intervention applies also to its actual carrying out. This is expressed in the introductory phrase of sub-paragraph (b). In this case too, though, all other duties continue to exist. This includes in particular the duty to inform in sub-paragraph (c).

Illustration 2

On a rainy autumnal day, B's fleet of construction vehicles have left residues of earth and building materials on the road. There is a great danger of an accident occurring. A, a neighbour, instructs a firm to clean the street without first telephoning B because due to the weather conditions A could not decipher the name of B's firm displayed on the vehicles. A's intervention was with reasonable ground. However, this does not free A of the duty to contact B if in the meantime A has learned about B's identity and telephone number – for instance, from an employee of the cleaning company instructed to clean the road. If A fails to contact B, B can set off against A's claim to reimbursement of expenditure the fact that B would have been able to dispose of the material on premises available to it much more cheaply than the road cleaning firm, which deposited the material (in the absence of contrary instructions) on a public authority site. The difference between the actual expense expended by A and this hypothetical cost which B would have incurred is a loss which A must carry.

D. The duty to inform (sub-paragraph (c))

A continual duty. Whereas V.-1:101 (Intervention to benefit another) paragraph (2) gives effect to the rule that someone who attends to others must first find out whether they in fact want that, V.-2:101(1)(c) clarifies that the duty to inform (and abide by the principal's decision to disallow any further interference) is a continual one: the intervener has a duty to keep the principal informed, so far as this is practicable and appropriate. This applies in particular when the intervener was unable to contact the principal before commencing the intervention, but it is not confined to that situation alone. As circumstances change, it may be necessary for the intervener to return to the principal to report on developments which might materially affect the principal's instruction.

“During the intervention”. All duties specified in this Article relate to the executory phase of a benevolent intervention. Clearly the nature of the continual duty to inform – or more precisely, the duty, so far as possible and reasonable, continually to make fresh attempts to reach the principal – is such that it can apply only in the case of benevolent interventions

which endure for any length of time; it cannot apply to measures which consist only of an instantaneous act.

An indicator of the intention to act for another. The performance of the duty to inform does not merely serve the interests of the principal. Informing the principal (or, depending on the circumstances, the attempt to contact the principal) also helps to reveal the intervener's intention to conduct another's affairs (required by V.-1:101 (Intervention to benefit another) paragraph (1)). Moreover, it points to the person for whom the intervener intends to act and helps identify the principal.

Providing the information itself amounts to a benevolent intervention. As stated before, the provision of information is in itself a benevolent intervention and consequently, if it necessitates expenditure, it can give rise to a claim for reimbursement where the conditions in V.-1:101 and 3:101 (Right to indemnification or reimbursement) are satisfied.

Content of the information required. When the intervener must make a fresh attempt to inform the principal and what the intervener must tell the principal once contacted are matters which turn on the circumstances of individual cases and cannot be answered in a statutory provision of general application. As a rule the intervener must inform the principal of the situation of danger which has arisen, the measures which have been attempted in order to eliminate it and what has happened in between. Above all it is essential that the intervener gives the principal the chance to forbid any further intervention.

Consent and contract. However, the intervener is not bound by the wishes of the principal if the principal desires the continuation of an act of benevolent intervention after its commencement. That is because no contract exists between the parties and there is consequently nothing from which a claim to performance could be derived. The duty to continue the act arises only under this Book and it exists only under the conditions envisaged in paragraph (2). Should the intervener, however, accept a request from the principal to continue an intervention or undertake a new one, then as a rule the matter will be governed from this point in time onwards by the contract arising between them. Moreover, one will mostly be able to proceed on the basis that such positive conduct of the principal denotes a conclusive statement of approval of the measures already undertaken.

E. The duty not to discontinue an act after commencement without good reason (paragraph (2))

General. Whereas paragraph (1) is concerned with the actual phase of acting in management of another's affairs, paragraph (2) addresses the question when the intervener may discontinue an intervention once it has been started. The basic rule is that everyone is free to decide whether to intervene in the affairs of another, but having once resolved to do so, must in principle bring the matter to a conclusion. The purpose of the duty to continue consists in the protection of the principal from the impetuous intermeddling of others. Potential interveners ought to appreciate that they will be assuming responsibility with their intervention. On the other hand, the duty to continue the intervention ought not to extend so far that an activity embarked upon as a non-contractual management of another's affairs ceases to be distinguishable from a specifically enforceable duty to perform an agreed contractual obligation. The law of benevolent intervention should give well-meaning persons an incentive to look after their fellow citizens. For that reason it must remain possible for an intervener to

venture the attempt to render assistance and to be able to give it up later if there is a good reason.

Good reasons to discontinue the intervention. Paragraph (2) deliberately does not list the “good reasons” for ending an activity in benevolent intervention; the matrix of possibilities in everyday life is too extensive. Without making claim to completeness, however, it is possible to compile the following list of four groups of cases: (i) achievement of the desired object, (ii) restoration of the principal’s capacity to act independently, (iii) the wish of the principal that the intervener desist from further measures, and (iv) reasons attributable either to the intervener’s circumstances (e. g. continuance would require unreasonable exertion) or the circumstances generally (e. g. uselessness of further exertion).

Achievement of the desired object. As soon as the intervention has achieved its purpose, that is to say, when the problem giving rise to the intervention has been solved, the intervener is not merely allowed to bring the intervention to an end. As a rule the intervener will also be obliged to refrain from other activity on behalf of the principal. (Whether further intervention would be justified or not has to be decided afresh in accordance with V.–1:101 (Intervention to benefit another.)) What remains at this stage are merely the obligation to report, account and surrender anything acquired by reason of the intervention. These are regarded by V.–2:103 (Obligations after intervention) as independent obligations consequential on the intervention and not as a mere part of a duty to continue an intervention.

The principal can reasonably be expected to take over. The intervener also has a reasonable ground to end the intervention if the principal can legitimately be expected to take over or resume the management of the matter. This will more often than not be the case as soon as the intervener draws the principal’s attention to the existence of the dangerous situation.

Actual or presumed contrary wishes of the principal. The intervener must discontinue the undertaking on becoming aware that the principal does not want it to be continued and the principal’s wish is not (by way of exception to the general rule) non-binding. Moreover, the intervener is also obliged by paragraph (1)(b) to act according to what may reasonably be supposed to be the wishes of the principal. Consequently the intervener must also desist from continuing the intervention if the circumstances are such that it would be reasonable to suppose that the principal would not want further measures to be undertaken. This is often the reason why a benevolent intervention is complete when it merely achieves a provisional ‘shoring up’ of the principal’s affairs. The decision as to the manner and timing of any permanent securing of the principal’s interest must as a rule remain reserved to the principal.

Unreasonableness. The intervener also has a good ground for ending the management of the principal’s affairs if it has become unreasonable to continue the intervention in the manner in which it was begun. What passes for reasonable or unreasonable depends on the particular circumstances and can hardly be expressed in an abstract formula. The personal circumstances of the intervener (dangers faced, pressure of time in regard to the discharge of other legal or social duties, the intensity of effort and time which has already been invested in the services rendered and would have to be invested in their continuation, etc) and the extent of the danger which cessation of the benevolent intervention would pose for the principal must be weighed up against one another. Within the boundaries of what is appropriate and reasonable the intervener is invested with a degree of discretion. As part of the balancing of interests,

moreover, one must ascertain whether and (if so) in what way the intervener has adversely affected the interests of the principal by the intervention up to that point in time and whether the intervener had the opportunity to secure the assistance of third parties. The test question in such cases is: would a careful person, placed in the intervener's situation and conscious of having voluntarily assumed responsibility for some affair of the principal, have done more?

Illustration 3

A person who helps someone and by doing so causes others, who would equally have helped, to go home, may not give up the assistance all of a sudden, since the injured party would now be completely helpless, whereas in the situation at the outset it might have been possible to count on the (enduring) intervention of others. The person helping must at the very least see to it that the emergency medical services or the police are notified.

Uselessness. Finally, a benevolent intervention may be ended if it emerges after a first attempt that it will not meet with success. Here too, however, it is conceivable that the duty to continue an intervention may take on the form of a duty to secure the help of third parties, should it transpire that the intervention has in fact made the situation worse.

Illustration 4

A has embarked on repair of the roof on the house of a neighbour, B, and, in order to be able to penetrate through to the damaged part, removes further tiles and roof battens. At this point it becomes clear to A that it will not be possible to carry out the repairs unaided and that it will be necessary to call in a professional roofer. Were it the case that A ought to have recognised this at the outset, then A would have been in breach of the duty of care under paragraph (1) and thus become liable for any additional damage to the building the intervention has caused.

Termination of the benevolent intervention without good reason. It does not suffice, however, as a reason for abandoning the matter in hand that the intervener has simply lost interest. Moreover, that is so irrespective of whether the interim intervention has increased the risk of damage to the principal in some shape or form.

Illustration 5

Of his own free will, A looks after the farm belonging to his brother, who is lying in a coma in hospital. After one year has passed, A decides to move into the city. He does nothing towards the administration of the farm and does not undertake or arrange for the tilling of the fields that should be carried out at this time of the year. A is of course not obliged to look after the farm permanently. However, he has not brought his benevolent intervention to a conclusion because he has failed to arrange what in the given circumstances was a reasonable solution for the future care of the farm (which could have consisted of a lease of the farm or, if there were no other relatives, its sale). A is liable to B for the damage suffered by the growth of weeds.

V.-2:102: Reparation for damage caused by breach of duty

(1) The intervener is liable to make reparation to the principal for damage caused by breach of a duty set out in this Chapter if the damage resulted from a risk which the intervener created, increased or intentionally perpetuated.

(2) The intervener's liability is reduced or excluded in so far as this is fair and reasonable, having regard to, among other things, the intervener's reasons for acting.

(3) An intervener who at the time of intervening lacks full legal capacity is liable to make reparation only in so far as that intervener is also liable to make reparation under Book VI (Non-contractual Liability arising out of Damage caused to Another).

COMMENTS

A. Liability to make reparation for breach of duty

The duty to make reparation under the law of benevolent intervention in another's affairs. Paragraph (1) establishes the intervener's liability for damages and thus at the same time the basis for a claim of the principal. Such provision appears necessary firstly because there should not be any discussion at the outset whether the principal's claim to damages arising out of the culpable execution of a benevolent intervention is in its nature derived from the law on non-contractual liability for damage under Book VI or must be derived from an analogous application of the contract law provisions. It is neither the one nor the other. Rather it takes the form of a claim to damages under the law of benevolent intervention itself. Secondly, paragraph (1) is required to give expression in a general rule to the specific limits of this claim to reparation.

Reparation. In agreement with the legal terminology being used in the law of non-contractual liability for damage under Book VI the concept of reparation embraces every form of making good on a damage. Usually this will take the form of compensation (monetary reparation; damages), but it may also assume another form of indemnification of the damage – in particular the restoration of the previously existing position by reparation in kind.

Damage. As in the law on non-contractual liability for damage under Book VI (in the concept of “legally relevant damage”) and the law of contract, the expression “damage” also encompasses here economic as well as non-economic losses. The provisions in the law on non-contractual liability for damage regarding compensation for damage suffered by close relations are applicable here too by analogy where the facts of the case call for it. The crucial point is always that the damage must be the consequence of a breach of a duty which is imposed by V.–2:101 and 2:102 upon an intervener whose intervention is justified in the sense prescribed by V.–1:101 and 1:102. Someone who intermeddles in the affairs of another without reasonable ground is liable for any damage which results not under the law of benevolent intervention, but under other provisions – in particular those of Book VI on the law on non-contractual liability for damage.

B. General limits to liability for defective execution of a benevolent intervention (paragraph (1))

Causation. The duty to make reparation for a breach of duty imposed on the intervener as such is limited by various requirements, first and foremost from the perspective of causation. Damage which has occurred does not generate a claim to reparation if it is attributable to a risk which gave cause for the intervener's measure or, to formulate the same proposition in positive terms, damage is reparable only if it results from the intervention. The intervener must have either created or increased the relevant danger, or else must have deliberately allowed it to continue.

Three situations. It is not enough as regards the required limitation of liability simply to point to the general instrumentality of causation. Rather what is needed is a specific connection between the breach of duty of the intervener and the damage which has occurred. That is because there is a host of cases in which the damage would not have occurred if the intervener had acted in accordance with the prescribed duties, but the damage would have occurred anyway if the intervener had not interfered at all. In situations of this type there has to be an exact examination of attributability of the damage to the intervention. Liability ought to be incurred in only three basic situations: (i) where the intervener has created the risk of damage by the intervention; (ii) where the intervener has not created that risk but has increased it; and (iii) where the intervener has terminated the intervention prematurely without reasonable ground and in the conscious assumption of the risk that damage will follow.

Liability for the realisation of a risk created by the intervener. An intervener is liable for the realisation of a risk of damage which the intervener has brought about. The mere omission to intervene to break a chain of causation which is already in progress does not generate any liability to compensate – even if a reasonable intervener would have behaved differently.

Illustration 1

As a result of heavy and sustained rainfall, an entire region is flooded. As the house owner is on holiday and has left no contact address, a neighbour decides to enter the house and rescue a suite of Chippendale chairs. The neighbour is not liable for negligence in failing to see that in the adjoining room there are other Chippendale chairs; nor for negligently failing to appreciate that it would have been more important to remove from the house a considerably more valuable Persian rug.

Liability for the realisation of a risk increased by the intervener. The intervener need not have created the risk; it suffices that it has been enhanced by the intervention.

Illustration 2

Customers in a supermarket find a handbag and hand this in at one of the tills. The cashier announces over the loudspeaker that the bag has been found and asks the owner, whose name is read from the identity card contained in the bag, to retrieve it. Since nobody comes to claim it, the cashier hands it back to the customers who found it, as they lead her to believe that they know the owner and will bring it to her. In fact they keep the bag and the money which it contained. The supermarket is liable for the loss because it increased the risk of the ultimate loss of the bag and contents in handing the bag back out, it being secure in the custody of the supermarket's employee following the benevolent intervention in taking possession. The case would be correspondingly the same in Illustration 1 if after rescuing the chairs the neighbour stores them so carelessly that they sustain damage while stored. That damage is attributable to the intervener's breach of duty.

The intervener intentionally perpetuated the risk. The third basic situation is a premature termination of the intervention in breach of duty (V.-2:101 (Duties during intervention) paragraph (2)). This breach of duty too ought not to lead to liability for all damage which results. In addition to the requirement of causation it must be established that the intervener has caused the perpetuation of the risk intentionally.

Illustration 3

Intervener I negligently supposes that all necessary repairs have been completed and thus leaves the scene of action. In fact the problem has not been remedied: a short time later water starts once again to pour out of the damaged pipe. I is not liable to the principal.

Illustration 4

The facts are the same as in Illustration 1, except that in this case the neighbour has carried the chairs out of the adjoining room into the hall, and has left them there, having suddenly become indifferent as to what happens to the chairs. The intervener has intentionally perpetuated the risk.

Intention. The meaning of the term “intention” follows the definition in VI.–3:101 (Intention).

C. Liability for others; multiple interveners

No general liability for other interveners. The text contains neither special rules on liability for the defaults of others nor particular provisions on situations in which several benevolent interveners become active. Liability of the intervener for a failure to choose with care a person to render assistance is already provided for by paragraph (1) in conjunction with V.–1:201(1)(a). Since there is no contract between the intervener and the principal governing the measure being undertaken and the intervener is therefore not obliged to the principal to undertake it, a genuine liability for the default of others fundamentally cannot be regarded as justified. The act of engaging another may, of course, be an act of benevolent intervention in itself, from which it follows that the intervener is obliged to surrender to the principal all the rights acquired under the contract made with the engaged third party. The risk of the third party’s insolvency is thus borne by the principal and not the intervener. The situation is otherwise where the intervener engages a third party in order to perform an obligation which is already imposed on the intervener, such as the obligation to deliver up and account. In that case the intervener is liable according to general principles for the non-performance of the obligation if the performance has been delegated to a third party who fails in that undertaking.

No joint liability of multiple interveners as a general rule. For the same reasons it did not appear to be justified to include a provision according to which multiple interveners would be jointly liable. Such joint liability may generally only be considered where several interveners are under the duty to undertake the same activity – a situation, however, which will be a rare exception.

D. Reduction of liability (paragraph (2))

General. The provision in paragraph (2) is a means of protecting persons who take care of others or their interests for especially commendable reasons. Paragraph (2) will typically (but not necessarily) operate in favour of emergency rescuers. The policy consideration behind paragraph (2) is therefore tied to one very specific aspect of benevolent intervention: the existence and extent of the (required) element of intention to benefit another. The fundamental belief that helpers who render assistance to another for altruistic reasons should be privileged as regards liability is familiar to all European jurisdictions. Only the means by which this fundamental belief is implemented differ. Some legal systems reduce the applicable standard of care to gross negligence, only granting this privilege to helpers acting in an emergency, whereas other jurisdictions engage a more open reasonableness test without altering the standard of care. Paragraph (2) adheres to the latter model. The fact that in urgent

situations of emergency non-professional helpers may easily misreact due to fear or precipitance is already taken into account in the context of the assessment under V.-2:101 (Duties during intervention) paragraph (1)(a): see the comments on that provision. Paragraph (2) therefore does not concern the basis of liability, but relates instead exclusively to the extent of the compensation. It is not confined to cases where the context to the benevolent intervention is the presence of a situation of imminent danger to another's body or health.

The fairness test. Liability may be either reduced or completely excluded under paragraph (2). Whether and to what extent such a reduction of liability (which in a suitable case may be a reduction to nil) applies will depend on a general fairness test ("fair and reasonable"). It must be determined according to the circumstances of the individual case and will depend in particular on the altruistic motive of the acting party.

Illustration 5

Mrs A looks after the estate of Mr X after he has died. She was due to inherit under a will, but has disclaimed the heritage. A dispute arises between Mrs A and Mr X's relatives concerning some animals which Mrs A has entrusted to the care of third parties. With regard to the majority of the animals Mrs A has acted in an exemplary fashion, whereas she has not timeously discharged her duty of information with respect to a goat and a sheep. The liability for damage may be reduced in the light of the altruistic motive of the intervener and the slightness of her oversight.

Illustration 6

A farmer, F, uses a tractor to tow away to the roadside a tree which had been uprooted by a storm; the removal was the responsibility of the local authority. Four months later the local authority has not taken any steps. At night an accident occurs. F has committed a fault by not completely removing the tree from the road and, together with the local authority, is liable to the road user as a joint debtor. However, inter partes F's share in the liability is to be reduced considerably below 50%.

E. Interveners without full legal capacity (paragraph (3))

General liability under the law on non-contractual liability for damage also required. The rule in paragraph (2) alone, however, does not offer the class of persons named in paragraph (3) adequate protection. Such persons ought to be liable to make reparation only if neither the law of benevolent intervention nor the general law on non-contractual liability for damage provides a protection against liability. The most important practical case is to be found in the law relating to the protection of minors and the rules on the minimum age for such liability (see VI.-3:103). Comparatively less important (but also to be considered) are the cases in which for other reasons there is liability in the law of benevolent intervention, but not in the general law on non-contractual liability for damage. That may come about because the intervener has infringed the duty imposed by V.-2:101(1)(b) to comply with the wishes of the principal, or the duty to continue an intervention (V.-2:101(2)) (which as a rule will be alien to the law of non-contractual liability for damage), or because the intervener has caused a damage which is not legally relevant within the concept of the law on non-contractual liability for damage.

V.-2:103: Obligations after intervention

(1) After intervening the intervener must without undue delay report and account to the principal and hand over anything obtained as a result of the intervention.

(2) If at the time of intervening the intervener lacks full legal capacity, the obligation to hand over is subject to the defence which would be available under VII.-6:101 (Disenrichment).

(3) The remedies for non-performance in Book III, Chapter 3 apply but with the modification that any liability to pay damages or interest is subject to the qualifications in paragraphs (2) and (3) of the preceding Article.

COMMENTS

A. General

Three obligations after intervention. V.-2:102(1) sets out the obligations which the party acting encounters after the activity: the obligation to report, to account and to hand over anything obtained as a result of the intervention. Among these, the obligation to hand over may be the most important in the practical application of the law. The intervener's obligation to deliver up extends to everything received by managing the principal's affairs. The intervener is additionally obliged to the principal to give information and an account. The main purpose of these obligations is to support the principal's claim for surrender. The obligation to report, however, is also effective in cases where a claim for surrender is not in consideration. Its purpose is to protect the principal against loss which might occur if the principal has no knowledge of the intervention and therefore refrains from taking necessary decisions or undertakes activity which in the changed circumstances will be wrong or useless. Paragraph (2) limits the claim for surrender vis-à-vis interveners who lack full legal capacity to the enrichment which they still have in possession (see D below).

“After intervening”. It will depend on the circumstances of the individual case at what point in time the management of the affair is completed. Frequently the intervention will be terminated as soon as the intervener discharges the duty to inform under V.-2:101 (Duties during intervention) with the result that the principal can take charge of matters. The obligation to inform under V.-2:103 (Obligations after intervention) may coincide in such cases with the duty under V.-2:101 (Duties during intervention) and may be discharged by the same act. In other cases the intervention will be completed if the dangerous situation which prompted the intervener to take action has been eliminated at least temporarily. Cessation of the intervention also occurs where the intervener decides to cease the management of the affair, whether for good reason or in breach of the duty to continue under V.-2:101(2).

“Without undue delay” All three obligations arising under V.-2:103 have to be performed by the intervener without undue delay. It will not infrequently be the case that the intervener has no knowledge of the principal's identity and reasonable inquiry has been made to no avail; those obligations cannot be discharged before the intervener learns of the principal's identity (name and address).

Obligations and rights. The principal's rights which arise under V.-2:103 (Obligations after intervention) may be enforced independently because their counterpart on the side of the intervener does not merely represent a duty of care or similar duties (as is the case in V.-2:101 (Duties during intervention)) but are actual obligations. The normal remedies for non-

performance of an obligation, including specific performance, are available. This however is subject to the qualifications in paragraphs (2) and (3).

B. The obligations to report and to account

The obligation to report. The intervener is obliged to make every reasonable effort to contact the principal and to give an account of the management of the affair – both after the intervention as well as during it. Thus the intervener is obliged to take the initiative. If the principal learns of the intervention, the intervener will have to provide information on request. If the intervener has not obtained any proceeds from the intervention, the obligations subsequent to the completion of the intervention will be limited to the obligation to provide information. The scope of this obligation will mirror its purpose of making the principal sufficiently aware of the situation as to be able to resume the management of the affair in question. The obligation to provide information is not dependent on the existence of a claim for delivery up; it may be, for example, that the intervener has to disclose the account books or files and allow inspection of them, but is not obliged to hand them over to the principal.

The obligation to account. The obligation to account in essence serves the purpose that the principal may obtain the information necessary to specify his claim for surrender of proceeds of the intervention. From a procedural perspective he may have to bring an action against the intervener by stages. The latter's obligation to account to the principal includes the obligation to provide an orderly and comprehensive overview of the separate expenses incurred and profits obtained which if needs be can be checked. To what extent and by what means this is to be carried out will depend on the circumstances of the case. Moreover the principal's request to account is also subject to the general reservation of the principle of good faith (III.–1:103(1) (Good faith and fair dealing). In a case of spontaneous assistance, such as between persons living in the same house or neighbours, much less may be demanded than in the case of management without authority of another's substantial assets or business. Here, depending on the circumstances, the obligation to account may perhaps only be discharged by supplying accounts satisfying professional standards.

Illustration 1

I, the daughter-in-law of a mentally disabled elderly man who has been admitted to a psychiatric institution for that reason, takes care of her father-in-law for a period of several years. His insurance company has remitted to her account the insurance payments which were owed to him. Out of this money I has made small expenditures for her father-in-law's benefit (clean bed linen, fruit, chocolate, cigarettes, taxi fares, replacement of glasses and alarm-clocks which he regularly breaks, etc.) until the death of the latter's wife, who consented to the expenditure. On the death of the father-in-law his heirs claim surrender of the insurance payments subject to a deduction of the expenses – specified precisely. The daughter-in-law cannot provide an account for these various minor expenses which in their entirety add up to a considerable sum, the more so, as she will not have received a receipt for the majority of these purchases. It would be contrary to the principle of good faith to request an account with a detailed list of all expenses. A rough estimation will suffice.

C. The obligation to deliver up

The most important economic obligation of the intervener. The obligation to deliver up to the principal all that has been acquired as a result of the intervention is in practice the most important obligation of the intervener. It is recognised in all jurisdictions of the European Union and follows from the nature of benevolent intervention as management of another's

affairs with the intention of benefiting another. It is part of its character that the intervener may neither be enriched nor suffer a disadvantage. The intervener acts on behalf of another; as a general rule the intervener's own financial situation should not be altered either positively or negatively. Thus the obligation to hand over all proceeds of the intervention finds its counterpart in the claim for compensation for expenses incurred under V.-3:101 (Right to indemnification or reimbursement).

Illustration 2

A person who collects the rent for the absent owner of a house must deliver up the money received.

Content and extent of the obligation to surrender. The principal's right to have what has been acquired surrendered (corresponding to the obligation of the intervener to deliver up) typically relates to the payment of monies received. More often than not it concerns the collection of receivables or the proceeds from the sales of another's goods (e. g. from the forced sale of perishable goods) or other assets (management of a bank deposit or sale of stocks). However, it may also occur that the intervener is obliged to hand over specific objects or documents. An example of the former is where the intervener has purchased a thing for the principal, but not as a representative of the principal, and the latter has subsequently ratified the intervention (cf. Illustration 30 at V.-1:101 (Intervention to benefit another)); the second situation may occur where the intervener has received a debtor's bond from the creditor, who in the meantime has been paid. The intervener may offset the claim for reparation against the principal's claim to deliver up proceeds or, as the case may be, withhold delivery until such time as the principal offers payment of the compensation due to the intervener.

Illustration 3

I in the course of a benevolent intervention purchases goods at a bargain price from X for P. For this transaction I has accepted a promise of a premium from X. If P pays the purchase price to I, then I must assign the right to the premium vis-à-vis X to P and transfer ownership of the goods to P.

Interest. The intervener has to deliver up "anything" obtained as a result of the intervention. Consequently this also includes interest on the monies received. If the intervener in the course of the benevolent intervention has received money and deposited it in an interest-bearing account, the claim for delivery up encompasses the interest as well as the money because the interest was received as a result of the conduct of the principal's affairs. If, however, the intervener has not deposited the money to earn interest, the question will arise whether the failure to do so was a breach of the duty of care under V.-2:101(1)(a) and (b). If there is no breach (because, for example, the intervener could not reasonably risk tying up the money for a long time in a savings account, though it later emerges that the intervener was only able to discover the principal's identity some six months later), then the principal has no claim for the interest foregone. On the other hand, if the intervener employs the money for the intervener's own purposes, this enrichment is being appropriated. The intention to benefit the intervener having at this point in time exhausted itself, the interest-earning deposit is not an act pursuant to the benevolent intervention. The basis for the principal's claim in that case is not one of damages for breach of the duty of care, but rather under the law of unjustified enrichment, or, as the case may be, under the law on non-contractual liability for damage.

D. Protection of interveners without full legal capacity

Paragraph (2). Although interventions by persons who lack full legal capacity are rare, they still occur. Children and mentally disabled adults may not be capable of binding themselves by way of contract, but they may nonetheless act as benevolent interveners if they can command sufficient capacity in fact to form the intention to look after the interests of another. They therefore enjoy the full legal protection of the law of benevolent intervention; they can look not merely to the rights conferred by V.–3:101 (Right to indemnification or reimbursement), but also to the protective mechanism of paragraph (2) which circumscribes their potential liability. This group of persons is only liable to the extent they are still enriched after the intervention: they are able to invoke the defence which is available in the law of unjustified enrichment based on change of position (VII.–6:101 (Disenrichment)). However, as paragraph (2) incorporates a defence from another Book by reference, the notion of good faith to be applied in this context, where the intervener can be expected to know at the moment of intervention of the prospective obligation to hand over any benefits obtained, may require a modified construction.

Lack of full legal capacity. The prerequisites for a person to enjoy full legal capacity and the different shades of less than full legal capacity do not form the subject-matter of these model rules. The only statement which can be made in this respect is that paragraph (2) applies in any event to interventions which consist of physical acts. No statement can be made as to which conditions enable a minor, either acting alone or with the consent of a legal representative, to effect or conclude juridical acts. For the time being the text assumes that every minor may rely on the defence of change of position. This includes a minor who has acted with the consent of a parent or legal representative. It may well be the case that this principle will require re-consideration if at some future date European model rules on the liability of minors and other persons lacking full legal capacity are formulated.

CHAPTER 3: RIGHTS AND AUTHORITY OF INTERVENER

V.–3:101: Right to indemnification or reimbursement

The intervener has a right against the principal for indemnification or, as the case may be, reimbursement in respect of an obligation or expenditure (whether of money or other assets) in so far as reasonably incurred for the purposes of the intervention.

COMMENTS

A. Two core elements of benevolent intervention

Chapter 3 in overview. The subject-matter of Chapter 3 consists of the rights of the intervener and the authority to act in the name of the principal (V.–3:106). V.–3:102 concerns the right to remuneration of interveners who act in the course of their profession or trade, V.–3:103 concerns the right to reparation of an intervener who has suffered personal injury in the course of a dangerous intervention, V.–3:104 the reduction or exclusion of the intervener's rights for compensation and V.–3:105 the principal's right to indemnification against a third party, who is accountable for the causation of damage which the intervener has intended to avert. In practice the most important of the intervener's rights, however, seems to be the right

to claim indemnification and reimbursement. These therefore are to be found at the head of the Chapter on the rights of the intervener. These rights in turn are the mirror image of the obligations of the principal. If the principal does not perform these obligations the normal remedies for non-performance under the general rules in Book III, Chapter 3 (Remedies for non-performance) will be available in so far as applicable to non-contractual obligations of the type in question.

Reimbursement and indemnification. V.-3:101 contains two core elements of the law of benevolent intervention – as understood at any rate in the continental European legal systems: the right of the intervener to reimbursement of expenditure and to indemnification of liabilities incurred. V.-3:101 thus distinguishes between the claim to reimbursement of outlays or other disbursements (reimbursement claims), on the one hand, and the claim for indemnification on the other. In this way the claim to reimbursement is flanked by a claim for indemnification. The intervener can also secure these rights in accordance with general rules by exercising a right to withhold performance: until the principal offers any reimbursement or indemnification which is due, the intervener may refuse to deliver up to the principal that which has been obtained in the course of the intervention. See III.-1:101 (Definitions) paragraph (4)(c); III.-2:104 (Order of performance) and III.-3:401 (Right to withhold performance of reciprocal obligations).

B. The right to indemnification

Indemnification. The right to an indemnification has as its operand the relief of the intervener from any liability properly incurred. Where possible, the intervener is to be saved from having to discharge the liability to a third party out of the intervener's own funds.

Illustration 1

If A, as a benevolent intervener, engages a service provider in A's own name to provide a service for C, then A has a right to expect C to settle A's liability to the service provider directly or at least to put A in funds in order to pay the service provider what is due.

Mode of indemnification. The claim to indemnification may be satisfied by the principal in one of two ways according to the principal's election: the principal can make a direct payment to the third party (the intervener's creditor), or can put the intervener in funds sufficient to enable the intervener in turn to pay the third party. So far as possible and reasonable, the intervener must alert the principal to the existence of the debt before the intervener discharges it. If in the circumstances the intervener had to pay before the principal could have an opportunity of doing so, then the intervener of course has a claim to reimbursement of the outlay. That claim may be asserted even in the case where the intervener discharged the debt without a compelling ground to do so before the principal's election. However, if in such a case the principal suffers damage because of that, the principal can set off against the intervener's claim a corresponding claim for damages.

C. The claim for reimbursement

Reimbursement. The second remedy is a right to reimbursement. In the context of a claim to reimbursement for burdens the latter may take the form of disbursements of money or the disposal of goods of value ("expenditure (whether of money or other assets)"). A liability incurred is also a "burden", but in that case, for the period before liability is satisfied by a monetary payment, the redress which the intervener is entitled to from the principal is indemnification.

D. General requirements applicable to both claims

The intervention must be reasonable but need not be successful. The main purpose of the law of benevolent intervention in another's affairs is the protection of the intervener's performance. The intervener's rights are therefore not dependent on an "enrichment" of the principal and thus also not on whether the intervention is in the end successful. It suffices that there was a reasonable ground to attempt the venture. It may be assumed that the principal would likewise have chanced an attempt, if in a position to make a decision personally.

No restriction to situations of emergency. V.-3:101 does not differentiate between help in a case of emergency and all other manifestations of benevolent intervention. It is enough that it was reasonable to seek to advance or safeguard the principal's interests; it is not possible to draw out different degrees of lesser or greater reasonableness within this test.

Reasonable expenditure. An intervener is entitled in relation to a principal to demand the amount of a debt to a third party which the intervener incurred, otherwise than as a representative of the principal, for the purposes of the intervention. This claim to indemnification of course only touches upon the internal relationship between the intervener and the principal. Moreover, this claim is subject to the same restrictions to which the reimbursement claim is subject: the obligation incurred must have been reasonable according to its nature and extent. The claims to indemnification and reimbursement are limited to such expenditure as the acting party was entitled to consider reasonable in the situation. In this regard the matter again turns on all the circumstances of the particular case – in particular the special difficulty of forming a view and decision-making in a situation of emergency.

Illustration 2

After damage caused by a storm to the roof on the property of a neighbour Y, the benevolent intervener X, instructs a roofing contractor to repair the damage. On being asked by the roofing contractor which roof tiles are to be used, X indicates roof tiles which are considerably more expensive than those which need replacement. Even if the new roof tiles are of a better quality, the expenses incurred will be unreasonable. X may only demand the (notional) costs of roof tiles which would have matched those which were replaced. Of course it would be different if the old roof tiles are no longer obtainable on the market and X thus had no other choice than to accept the offer made by the contractor. But the expenses would also be unreasonable if under the prevailing and forecast weather conditions a provisional repair would have been possible and it had been known that the principal would soon return. In such a case the decision on a lasting solution should have been left to the principal.

Illustration 3

After a traffic accident a vehicle has to be towed away. The company instructed tows the car to a storage place which belongs to the company but is far away and where further costs are incurred. It would have been possible to bring the vehicle to the owner's place of residence. The company could have easily ascertained the address by asking the police. The costs so far as they exceed the expenses which would have been incurred had the vehicle been towed to the owner's residence are not recoverable.

Interest on expenditure. The draft does not envisage an independent claim to interest on expenditure. The reason for that is that an intervener should be entitled to receive reimbursement only for the disadvantages actually sustained by managing another's affairs and those disadvantages are already covered by the rule. The text proceeds on the footing that

an intervener may obtain reimbursement of debt interest actually paid as much as for interest foregone on funds in credit in the concrete circumstances of the case, provided that the intervener can prove that this interest has actually been foregone; but the intervener is not entitled to a claim for interest foregone in the “abstract” (that is to say, by irrefutable presumption of loss). Hence also it is not necessary to lay down a rule governing the quantum of such an “abstract” claim to interest. The right to interest on expenditure from the point in time at which it is incurred is parasitic on the right to reimbursement. Hence, most obviously, the intervener is entitled to interest only on that expenditure for which there is a right to be reimbursed because it was reasonable for it to be expended; it does not apply to expenditure which was in fact incurred, but which, for the purposes of the right of reimbursement, is disallowed. However, if the principal delays in paying over the amount of any reimbursement or indemnification after payment has become due, then interest on the amount outstanding would be payable in accordance with the normal rules (III.-3:708 (Delay in payment of money)).

Illustration 4

The roof of X’s historic mansion is severely damaged in a storm while X is on a yacht somewhere in the Atlantic ocean and Y, a helpful neighbour, cannot make contact. Emergency repairs to X’s roof must be sensitive to the heritage of its construction (something which to Y’s knowledge X sets great store by). There are also paintings and furniture in the endangered upper storey which must be moved to protect them from the elements. All of this is beyond Y’s meagre budget. So Y obtains a loan from a bank at the going rate. Y is not merely entitled to reimbursement of the loan received from the bank which has been used to pay for the necessary repairs and removals. The interest which Y pays to the bank, discharging an obligation which was properly incurred in order to perform the act benefiting the principal, is also expenditure which must be reimbursed and which is subject to interest from the time of payment. The same principle would apply in the case of a hire-purchase. However, Y would not be entitled to any interest on expenditure if the sum owed to the contractors was rather small so that Y could pay it in cash with money which would not have been paid into an interest-bearing account anyway.

Expenditure, whether of money or other assets. If the intervener has paid out money, the claim to reimbursement is in respect of this form of “expenditure.” “Expenditure of other assets” encompasses by contrast all patrimonial detriments which are voluntarily sustained, but do not take the form of an outlay of money. “Expenditure” is the umbrella term for obligations incurred, outlays and other contributions. Hence, “expenditure” for the purposes of the intervener’s right of reimbursement under V.-3:101 covers not only out of pocket expenses. It extends to any form of voluntary disposition out of the intervener’s own patrimony responsibly devoted to the cause of the principal’s benefit. Thus it will include, for example, the intervener’s loss of property when this is intentionally disposed of or when the intervener voluntarily acts to cause its destruction as part of the performance in the principal’s interest. (*Involuntary* damage to property may fall to be compensated under V.-3:103 (Right to reparation)).

Illustration 5

A woman who, as a benevolent intervener, employs her own motor vehicle for the benefit of another may claim not only compensation for the fuel used but also compensation for the fact that she could not otherwise make use of her car during the material time.

Services. However, “expenditure” does not extend to investment of labour, for which only professional or commercial interveners may make a claim within the limits provided for in V.-3:102 (Right to remuneration). This does not mean that the non-professional intervener can never make a claim for remuneration for labour. Such an intervener will be able to do so if it can be shown that the labour has enriched the principal and the enrichment gives rise to a claim under the law of unjustified enrichment.

Loss of income. “Expenditure” likewise excludes any claim for loss of income which the intervener sustains because of being preoccupied with the interests of the principal. That is a matter of damage and not of expenditure in this sense of an outlay or contribution.

V.-3:102: Right to remuneration

(1) The intervener has a right to remuneration in so far as the intervention is reasonable and undertaken in the course of the intervener’s profession or trade.

(2) The remuneration due is the amount, so far as reasonable, which is ordinarily paid at the time and place of intervention in order to obtain a performance of the kind undertaken. If there is no such amount a reasonable remuneration is due.

COMMENTS

A. Remuneration of professionals (paragraph (1))

Should there be a right to remuneration? Paragraph (1) confers on persons who intervene in the course of their profession or trade a claim to remuneration. That they should have such a claim is by no means self-evident. The substantive appropriateness of such a rule, which can be found in many, but certainly not all, legal systems of the European Union, can indeed be disputed in terms of legal policy. Is it at all possible to maintain that someone who demands remuneration for the action predominantly advances another’s interests? Is it not a contradiction of the “spirit” of the law of benevolent intervention in another’s affairs to allow a claim to remuneration? And why should a lay person not have the same rights as someone who undertakes the intervention in the course of a trade or profession?

Underlying policy considerations of the rule. The first question can doubtless be answered affirmatively. All that the intervener has to demonstrate is that the conditions of V.-1:101 (Intervention to benefit another) are met. A doctor helping someone who lies unconscious or a breakdown recovery service salvaging a car which has been involved in an accident and whose owner has already been admitted to hospital are capable of acting predominantly with the intention of helping the person concerned. That they ultimately submit a bill for their service does not change their state of mind at the time of acting. The matter only becomes problematic when the active party mentally inverts the relationship between the reason for and the consequences of the action – by acting predominantly for the purposes of acquiring a right to remuneration. Such persons are not interveners and consequently are assigned to the law of unjustified enrichment (including its restrictive rules on unsolicited enrichments).

Illustration 1

X, a genealogist, earns a considerable part of his income by professionally searching for heirs. He reacts to public announcements of estates of persons who according to

the knowledge of the authority in charge do not have any relatives and thus no successors. At the expiration of the time-limit indicated in the announcement the intestate estate will devolve to the state. X succeeds in tracing a relative (Y) of a deceased person and offers to disclose to Y the necessary information for a consideration of 20% of the inheritance. In order to indicate the reliability of the offer X discloses some vague information. Y declines the contract offered. However the information provided suffices to enable Y to locate the authority concerned and to accept the inheritance. Y is not indebted to X.

The claim to remuneration under paragraph (1) is thus conceived as a claim consequential on an undertaking which was *not* rendered with a view to an expected counter-performance. Such a claim, however, does not in any way contradict the spirit of the law of benevolent intervention in another's affairs.

Illustration 2

I, a professional shipping agent by means of a justified benevolent intervention in the course of an auction purchases three tank ships for P. P is obliged to pay to I the usual remuneration for such action.

Remuneration only for professionals. There are good reasons of legal policy for treating private individuals differently from persons who intervene in the course of their profession or trade. Firstly, a professional is likely to give a greater input than an amateur so that the former's performance from the perspective of the benefited party is as a rule simply more valuable than the latter's. In this respect the rule supports both core elements of benevolent intervention: the protection of the performance of the intervener and (albeit on a lower plane) the aspect of usefulness of the undertaking anticipated at the time of its commencement. Related to this is the further argument that remuneration is justified for provision of a professional level of performance as a correlative of the higher (professional) standard of care to which an intervener who acts as a professional will be implicitly subject under V.-2:101 (Duties during intervention) paragraph (1)(a) (see Comment B under that provision). Additionally the law of benevolent intervention in another's affairs aims to establish incentives for humane action. For professional providers of services the incentives to act must be more pronounced than for private individuals.

The main policy consideration. One can of course muster against the rule the fact that it may make no difference to the aspect of the intention to benefit another, which is at the same time constitutive of benevolent intervention, whether the action falls within the intervener's professional or commercial field of activity. The argument would then run that an intervener always acts "privately". However, this objection too is not convincing: an intervener who, from lack of time, expertise or ability, is not confident of being able to do what is required may naturally commission a professional to undertake it and can then pass the bill to the principal. Assuming this starting position it makes no sense to cut off an intervener who happens to be a professional from the possibility of billing for services rendered. That is probably the strongest policy consideration in favour of the rule. Furthermore, the criterion of reasonableness ensures that the intervener as a rule is only authorised to undertake provisional measures.

"Undertaken in the course of the intervener's profession or trade". Moreover, it must always be examined whether assistance is actually rendered "in the course of the intervener's profession or trade". Falling under that rubric, for example, would be a doctor who while on

holiday gives aid at the hotel to a fellow guest who has fallen unconscious beside the swimming pool, but it would not cover someone who at the time of undertaking the relevant activity no longer practises the profession or has ceased to pursue the trade (for example, a doctor who has retired).

Non-profit organisations. The formula “profession or trade” includes not-for-profit organisations. If such organisations, constituted as legal persons, intervene, they will often equate to “trade” on account of the legal form which their organisation takes, irrespective of the fact that they are not orientated towards making a (distributable) profit. Where the applicable national law does not allow for that outcome, such organisations are encompassed by the expression “profession” if and to the extent that they have been formed for the purpose of rendering assistance, they have rendered that assistance to a professional standard and the intervention in question stems from their activity in that area.

Reasonableness. The claim to remuneration – just like the claims under V.-3:101 (Right to indemnification or reimbursement) – requires that the measure undertaken was reasonable according to its nature and extent. More often than not it will only be reasonable to undertake provisional measures and thus all services rendered beyond this will, if at all, only confer a claim for compensation according to the rules of unjustified enrichment. In any case no claim for remuneration will arise under the law of benevolent intervention.

B. Quantum of remuneration (paragraph (2))

The usual price. With regard to the quantum of remuneration, the basic principle is that the principal must pay for that breadth of performance which the principal, if in a position to do so, would reasonably have had to commission. To make this notion more concrete the Article takes as the fundamental benchmark the usual price at the time and place of the intervention. Where tables of fees exist (e. g. for the services of self-employed persons), these are to be adopted. In the rare case where there is no such usual price, a reasonable remuneration is payable.

“So far as reasonable”. The economic activities of life are, however, so multifarious that the rule as to usual price must be subject to the general test of reasonableness. It may be that the intervener must act at a multitude of different places, but it is not sensible to ascertain an individual customary price for each of them. One can contemplate cases in which an intervener was overqualified for the performance rendered, but there was nobody else available who could have rendered it. Other cases which can be imagined include those for which no bearable expenditure would yield a local market price. In such cases the judge is left with no other choice than to make a general evaluation of all the circumstances of the particular case. Where assistance is rendered to someone who lacks full legal capacity, that may likewise be a relevant factor for the purposes of paragraph (2). Had the principal been able to conclude a contract for the assistance rendered – exceptionally so, precisely because it was aid in an emergency situation – no further considerations are required. On the other hand, had the principal not been in a position legally to conclude a contract, the case in this special situation resolves according to its nature into an unjustified enrichment claim and that must be taken into consideration in calculating the quantum of the claim.

V.-3:103: Right to reparation

An intervener who acts to protect the principal, or the principal's property or interests, against danger has a right against the principal for reparation for loss caused as a result of personal injury or property damage suffered in acting, if:

(a) the intervention created or significantly increased the risk of such injury or damage; and

(b) that risk, so far as foreseeable, was in reasonable proportion to the risk to the principal.

COMMENTS

A. The right to reparation for concomitant damage

Policy considerations. V.-3:103 is based on a simple consideration of justice. If a person undertakes an intervention to protect another person or another person's property against damage but in the course of this act himself or herself sustains damage then a decision must be made as to who is to bear such damage: the intervener or the principal. This Article, in line with the overwhelming majority of European legal systems, has decided to choose the second alternative. Only this solution corresponds to one of the main objectives of the law of benevolent intervention: the protection of the justified intervener.

Need for regulation. V.-3:103 is indispensable because V.-3:101 only secures that the principal will discharge the obligations the intervener has incurred and will reimburse expenditure made. Thus V.-3:101 concerns patrimonial detriments which are voluntarily sustained by the intervener. Involuntary patrimonial detriment ("damage") does not come within the scope of the regime provided for by V.-3:101. This will be dealt with by V.-3:103.

Consideration of the principal's interests. The decision of general principle in favour of the intervener in some respects requires further specification. V.-3:103 subjects the claim for damages to the condition that the damage in question is a typical realisation of the risk incurred. The realisation of the general risks of life will not give rise to a claim. Additional provisions in V.-3:104 (Reduction or exclusion of intervener's rights) and 3:105 (Obligation of third person to indemnify or reimburse the principal) further alleviate the burden on the principal. If and to the extent that state insurance schemes or insurance schemes prescribed by law provide for compensation of the intervener this may, depending on the circumstances, operate to relieve the principal under V.-3:104(2). See the comments on that principle.

Relationship to the law on non-contractual liability for damage. V.-3:103 adds an independent concurrent right to those provided by the general rules on non-contractual liability for damage (Book VI). If the principal is also liable to the intervener under those general rules the intervener may rely on the compensation scheme which is more favourable.

B. The individual requirements of the right

A strict liability outside the general law on non-contractual liability for damage. V.-3:103 amounts to a strict liability (i. e. a liability without intention or negligence on the part of the principal) in damages to the intervener. If, by contrast, the principal's liability for damage depended on the principal's wrongful conduct or fault, then the rule would more often than not prove to be superfluous. For in these cases the principal's liability would already arise under the provisions of the general law on non-contractual liability for damage (Book VI).

Illustration 1

A car driver is badly injured because he steers his car into a field in order to avoid a person who has suddenly rushed out in front of his car. According to the rule in V.–3:103, liability is imposed on that person, even though he might not, for some special reason, be liable under the general law on non-contractual liability for damage. The person may for instance be a cyclist who has suffered a hornet-sting and in consequence has lost control of his cycle for an instant and thus swerved into the oncoming lane.

Reparable damage. Damage which can give rise to a claim for reparation consists of injury to the person and damage to property and the damage which arises consequential on those (extending to economic as well as non-economic consequential losses). In contrast, so-called pure economic losses (meaning, here, losses which are not the consequence of bodily injury or damage to property) do not support a claim to reparation under the law of benevolent intervention in another's affairs. That is connected with the special nature of that economic damage and with the fact that fundamentally there should be no compensation for an expenditure of time (i.e. what the intervener might otherwise have earned during the time devoted to the benevolent intervention and therefore forewent in order to act). Personal injury is defined in VI.–2:201, as is damage to property in VI.–2:206(2)(b). According to the latter provision "property damage" will only cover damage to the physical integrity of a thing.

Illustration 2

If A rushes into B's burning house in order to save B, stranded in a smoke-filled bedroom, and sustains severe burns as well as ruining her clothing, B may be liable to compensate A for her personal injury, the lingering pain and discomfort associated with the damaged tissue, the loss of income while she is under treatment and recovering her health and the more trivial damage to her property. However, if A, in order to rescue B, must forego a business appointment, B will not be liable for A's economic loss consequential on the missed appointment. In order to avoid all argument about whether such items of damage are attributable to the risks generated by the benevolent intervention, pure economic losses have been removed at the outset from the protective sphere of the claim to reparation.

Damage suffered by third parties in consequence of the intervener's death. With regard to personal injury, however, liability under this provision may be as extensive as liability would have been in the law on non-contractual liability for damage in a case of liability independent of breach of duty. Hence, if the intervener has suffered a fatal injury in attempting to protect the principal, the principal will be liable to the intervener's successors and dependants in a manner analogous to the corresponding provisions in the law on non-contractual liability for damage (see VI.–2:202 (Loss suffered by third persons as a result of another's personal injury or death)).

General limits of the principal's liability. Since the liability provided for in V.–3:103 is strict (see *B5* above), some further limitation to its scope seems to be appropriate in order to ensure that a just balance is struck between the conflicting interests of two innocent parties.

Protection against danger. Under the rule a claim to damages only comes into consideration if, firstly, it is a case of emergency which is in issue. There must be a damage which the intervener sustained by trying to protect the person, property or other interests of the principal

“against danger”. A danger is understood to exist where the situation will in all likelihood take a turn for the worse.

Illustration 3

After his graduation ceremony P, who is completely drunk, gets behind the wheel of his car. I takes away the key from P, who refuses to listen to reason, and himself gets behind the wheel. I acts to rescue P from danger. P's protest is irrelevant as he is in a state which renders him incapable of forming a legally relevant will.

Questions of causation. V.-3:103 also makes it clear that in order to make the principal liable for the realisation of a danger in the form of damage of the specified type, a particularly close causal connection is required between the intervention and the endangerment of the intervener. Not every damage which is causally connected to the act of the intervener will fall within the provision.

Damage suffered in acting. Firstly, damage must be suffered “in acting”, and hence in the course of an undertaking to protect the person, property or other interests of the principal. The field of potential liability is opened up only from the point in time when the intervener commences the protective act – that is to say, the act which in fact provides protection or, were it not frustrated by nature or the intervention of third parties, would have rendered protection.

Illustration 4

In illustration 2, A is entitled to claim from B’s estate for her damage even if A is unfortunately beaten back by the heat and B cannot be rescued. This point in time arises only when the intervener confronts and engages with the danger surrounding B or B’s interests because an act of rendering protection is the process of eliminating the danger. Hence, if, in racing to reach B’s burning house, A has rushed from her shop leaving it unlocked and it is looted in her absence or A has been knocked down by a passing vehicle while crossing the road then, quite apart from considerations of A’s contributory want of care or the wrongful conduct of third parties in causing A’s damage, A could not have a claim against B under this Article because such losses are not sustained “in acting” to render protection. They are losses sustained by A merely in placing herself in a position from which she is then able to render or attempt to render protection. The same is true where A trips on a loose flagstone in the path to B’s house, breaks a bone and never reaches the burning front door. Any redress which A might have against B in such a case lies in the general rules on non-contractual liability for damage.

Illustration 5

For one evening and one morning I attends to the animals of his unmarried neighbour who is also a farmer and had to be taken to hospital suddenly due to a heart attack. An infectious animal disease has broken out. Without the fault of any party, since it could not yet be known that P’s animals have been infected, I transmits the virus to his own herd. The damage is a mere consequential loss and thus does not qualify as damage which I has suffered “in acting”.

Created or significantly increased risk (sub-paragraph (a)). Secondly, the risk that such damage would be incurred must be “created or significantly increased” by rendering the

specific protection. By contrast, all other risks will (even in the case of an emergency) fall within the ordinary hazards to which a helper is exposed.

Illustration 6

The owner of a grocer's shop sees an accident occur in the immediate vicinity of the shop and shuts the shop in order to help. (The loss of income is not a compensatable damage.) Should the grocer drive the victim to hospital and in the course of the journey a further accident occur in which the grocer's car is damaged, this damage too is only sufficiently closely bound up with the act of rendering assistance if in the circumstances it was necessary to adopt a particularly risky approach to making the journey by car.

Reasonable proportion between the danger to the principal and the risk incurred by the intervener (sub-paragraph (b)). Secondly, the intervener's right to reparation arises only if the intervener has not incurred an unreasonable risk. Ultimately this follows simply from the general principles as it cannot be in the principal's interest that the intervener assumes an unreasonable risk. In a normal case it might be unreasonable, for example, knowingly to endanger one's own life or health in order to save the property of others. This principle of proportionality may also be conceptualised in categories of causation. If a reasonable person in the circumstances would not have felt called upon to act in the manner in which the intervention was undertaken, then the risk realised should not be qualified as a consequence of the danger threatening the principal.

Illustration 7

The intervener's risk could be defined as the product of the probability of loss occurring and the extent of probable damage. If, as an example, there is a high probability (50%), that the intervener by the intervention would incur a comparably low property damage (ruining a suit which has a value of €1000) in order to preserve another's property of high value (a valuable painting or a laptop computer containing important data of which no backup copy exists), then the intervener incurs a reasonable risk even if the danger that the painting or the computer (value €10000) would be lost were comparatively low (10%).

“So far as foreseeable”. The disproportionality between the danger to be prevented and the risk incurred however must have been observable for the intervener in the circumstances of the case. The risk of a reasonable but inaccurate estimation of the actual situation will again have to be borne by the principal.

Illustration 8

This may be illustrated by the example of a person entering a building in which the principal has stored dangerous substances of which the intervener could not have any knowledge and which endanger the lungs. Had the intervener known, or could reasonably be expected to have known, of the danger it would have been unreasonable to even attempt to rescue valuables in such circumstances.

Intervener's contributory fault. The contributory fault of the intervener (for example, A runs into the neighbour's burning house in highly inflammable plastic clothing) will result – in accordance with general principles – in a commensurate reduction of the quantum of the claim to reparation. It does not, as a matter of principle, lead to elimination of the claim to reparation. A complete exclusion of the claim to reparation by reason of contributory fault

only comes into play if the damage is really entirely attributable to the intervener because the intervener behaved in a way which is beyond all bounds of reasonable conduct. In assessing whether the intervener is contributorily at fault, however, all the circumstances of the particular case have to be taken into account and, in particular, the fact that in a case of emergency not much time is left for consideration. In a panic situation, it cannot be expected that someone who is not specially trained to cope with such predicaments will proceed with the same care and consider the matter with the same level-headed deliberation as would be demanded in normal circumstances.

V.-3:104: Reduction or exclusion of intervener's rights

(1) The intervener's rights are reduced or excluded in so far as the intervener at the time of acting did not want to demand indemnification, reimbursement, remuneration or reparation, as the case may be.

(2) These rights are also reduced or excluded in so far as this is fair and reasonable, having regard among other things to whether the intervener acted to protect the principal in a situation of joint danger, whether the liability of the principal would be excessive and whether the intervener could reasonably be expected to obtain appropriate redress from another.

COMMENTS

A. Acting with *animus donandi* and related cases (paragraph (1))

Legal certainty. V.-3:104(1) has been prompted by reasons of legal certainty. The provision is a clarification which is found in the same or a similar form in statutory rules on benevolent intervention and, beyond that, is a generally accepted principle. One who acts with an intention of conferring a benefit gratuitously without wishing any indemnification, reimbursement, remuneration or reparation (or with *animus donandi*, to use the older terminology) has no claim to compensation. In an individual instance it may of course be the case that the acting party has acted with *animus donandi* only with respect to particular rights and not all of them. A case in which it is particularly advisable to examine whether the intervener was looking to the principal for reimbursement of expenditure at the time of performance is where maintenance is paid to close relatives. In a case of doubt one would proceed on the footing that the intervener certainly intended to have recourse against the person obliged to provide the maintenance, but acted with a donative intent in relation to the recipients.

Illustration 1

A man and a woman cohabit for three years without being married. During this period the woman has improved the apartment by her good taste and style and in consequence increased its value. She is not entitled to claim monetary compensation for the services she has provided as an expression of her affection. This was done merely out of friendship.

No waiver of rights. It may also be noted, at a more general level, that we are not concerned here with a waiver of rights; instead the intervener has no right from the outset (and there is thus nothing which can be waived). Paragraph (1) does not allow for any doubt about that because it takes as the decisive point in time the moment when the intervener acts; a later

change of mind is not material. Whether the intervener at the time of acting had the intention of intervening without a given recompense and, if so, which recompense that intention concerned are questions which in the absence of express statement by the intervener are to be answered by interpretation by employing the same criteria as are to be found in II.–8:101 (General rules) and II.–8:102 (Relevant matters) paragraph (1).

The other rules of the law of benevolent intervention remain applicable. V.–3:104 and in particular paragraph (1) does not alter the starting point that a person acting with *animus donandi* may still be a (justified) intervener within the meaning of this Book. The principle set out above merely grants the principal a defence and does not constitute a (negative) precondition for the application of the law of benevolent intervention. This can already be deduced from V.–1:103 (Exclusions), which does not mention *animus donandi*. Thus the intervener will remain under the duty to act carefully and provide information and the obligation to surrender proceeds.

The scope of paragraph (1). Paragraph (1) is not limited to the right to reimbursement of expenditure or the pre-emptive right to indemnification. It equally embraces the right to remuneration and the right to reparation. That follows from the unqualified language of the article.

Illustration 2

During a privately organised football match among friends, a player is injured. Another player who happens to be a doctor provides makeshift aid to the injured party on the spot. It is to be presumed in the circumstances that there is no scope for a claim to remuneration: the incentive for rendering first aid is predominantly friendship and the joint activity. This is irreconcilable with a claim for reimbursement.

Illustration 3

In P's apartment a quarrel between the father P and his son X turns violent. I, the other son, comes to his father's assistance but in the course of the events is injured at his wrist by a blow X delivers with a plate. I (or rather his health insurance which wants to assert a claim against the father on the basis of subrogated rights) does not have a claim against P. The assistance provided to P by I arose from family commitment and was based on the bond of affection between father and son.

B. Reduction of liability on grounds of equity (paragraph (2))

General. Paragraph (2) provides for a reduction of the intervener's rights on grounds of equity. In litigation this grants a discretionary power to the court. At the same time paragraph (2), without claiming to be exhaustive, sets out the most important reasons, which may give rise to a reduction of the right.

Scope. Paragraph (2) primarily has the right to reparation under V.–3:103 (Right to reparation) in focus, but it is not restricted to this right. In fact it also concerns the intervener's rights to indemnification, reimbursement and remuneration.

Illustration 4

An example for the reduction of the right to reimbursement of expenditure in a situation of joint danger has already been given in Illustration 17 under V.–1:101 (Intervention to benefit another).

Reasons to reduce or exclude the principal's liability. The liability of the principal is subject to the general restriction that it must not be inequitable in the circumstances of the particular case. Paragraph (2) specifies a number of aspects which might make it justifiable to reduce or even exclude liability. However, the reasons which the provision offers for a possible reduction of liability are not exhaustive. The provision merely makes explicit the most important cases.

Joint danger. Expressly mentioned is the situation of common danger, an aspect which originates in the law of general average. In a situation of common danger for which neither the intervener nor the principal are accountable the rule will generally be that liability must be divided.

Illustration 5

The case of a driver of a motor vehicle who avoids hitting a teenage pedestrian, who suddenly appears in front of the vehicle but is not responsible for this mishap, may serve as an example. A further example may be found in Illustration 4.

The principal's economic capacity. However, the economic capacity of the principal also calls for consideration. A measure undertaken in benevolent intervention in another's affairs can easily lead to costs and damage whose indemnification may lie beyond the financial capabilities of the principal (especially if the principal is a child). Of course it is impossible to frame a rule which will suit all cases; ultimately the decisive question will always be whether or not it is fair and reasonable to reduce liability in the particular circumstances. In general such reduction will be considered more in relation to the intervener's right to reparation than with regard to the right to reimbursement: expenditures in general result to the principal's benefit, whereas damage sustained by the intervener naturally does not afford any benefit to the principal. Thus the claim for reimbursement of expenditures which have contributed to the successful outcome should only be reduced in rare and exceptional cases, as for instance if the costs of financing a measure are concerned, which the principal, if asked, would have declined for economic reasons.

The intervener can reasonably obtain redress from another. The principal ought generally to be liable in only a subsidiary way if it is reasonable for the intervener to look to another to obtain redress. This applies in particular to compensation for damage caused wrongfully by a third party. If such a third party can be identified as a wrongdoer who clearly has assets sufficient to satisfy the intervener's claim, then the intervener must look to the third party. The risk of the third party's inability to pay, however, must be placed on the principal rather than the intervener (see V.-3:105 (Obligation of third party to indemnify or reimburse the principal)).

Illustration 6

A hotel keeper asks a guest to assist in the apprehension of a robber. The guest acts on the request, but in the course of events is wounded by a gunshot from the robber. As a rule the hotel keeper will be liable to the guest under V.-3:103 (Right to reparation). However, this liability will be reduced in so far as the guest can actually obtain compensation from the robber.

Rights against an insurer. It is fair to oblige the principal to ensure that the intervener is protected against damage when the latter must otherwise personally carry the risk of being placed in danger. However, if the intervener has a viable claim against an insurer, then the question may arise whether the insurer should be entitled to recourse against the principal. This will be relevant in particular with regard to personal injury of persons rendering assistance in an emergency. As the latter for practical reasons will turn first to their insurance the problem is ultimately whether or not the insurer should be granted a right of recourse (against the principal whose insurance cover will usually not extend to the obligation to compensate arising from the law of benevolent intervention) by means of an assignment by operation of law. This question too cannot be answered by a comprehensive rule appropriate to all cases. The decision should turn on considerations such as the basis of the insurance cover and the extent and the funding of the insurance. For example, many Member States of the European Union have established a public insurance body, which compensates persons who have injured themselves in the course of rendering assistance to another. So far as such (state-run) health insurance for the benefit of emergency rescuers is funded by public tax revenues, the principal should not be burdened with liability for the intervener's personal injury: as everyone pays, everyone should profit. This is even more so where the reason for insurance cover may also be the fact that the legislator has imposed a sanction on failure to render aid. Where the insurance cover is not funded by taxes, but instead secured by contributions of (for example) either only employees or only employers, then there is no good reason why third parties who have not made any contribution (in this case: the principal) should profit from such payments, i. e. why they should not be subject to the insurer's recourse. Of course the principal's liability will be a precondition for such recourse; without the principal's liability to the intervener there is nothing which can be subrogated to the insurance company.

Illustration 7

A is a witness of an attack on a tourist at an underground station. He comes to the tourist's aid, but is himself injured. To the extent that A benefits from statutory non-contributory insurance, his claim against the tourist is correspondingly reduced by the amount received from the insurer. The operator of the insurance scheme acquires A's right to reparation from the attackers, but not A's claim against the tourist under the law of benevolent intervention. That is because A has no claim which is capable of transfer to the insurer.

12. Burden of proof. The burden of proof lies with the principal. The principal must assert and in a contested case prove that the requirements of paragraph (2) are satisfied.

V.-3:105: Obligation of third person to indemnify or reimburse the principal

If the intervener acts to protect the principal from damage, a person who would be accountable under Book VI for the causation of such damage to the principal is obliged to indemnify or, as the case may be, reimburse the principal's liability to the intervener.

COMMENTS

Purpose of the rule. V.-3:105 concerns the situation in which the intervener prevents damage for which, had it occurred, a third party would have been liable to the principal according to the general law on non-contractual liability for damage (Book VI). In other words the intervention has prevented impending damage to the principal or the principal's

interests. But it has resulted in detriment to the intervener: for instance, the incurring of expenditure or the sustaining of damage. If and in so far as the principal is liable to the intervener in respect of such detriment, the principal is entitled to recourse against the third party. The third party is not to be relieved from liability by the fact that another (the intervener) has prevented the damaging event. Thus the principal is freed from the burden of establishing that the principal's *liability to the intervener* constitutes in relation to the third party "legally relevant damage" and that with respect to *this* damage (which in fact is a pure economic loss) the other requirements of liability under Book VI (causation and accountability) are met.

Illustration 1

Miscreants untie a yacht from its moorings and it threatens to drift away. The owner of another yacht motors up alongside it, but in heading back to the quay damages his own engine. In such a case the owner of the drifting yacht can be looked upon as the benefited party (the principal). Consequently, the owner of the second yacht will have a claim for damages to the value of the costs of repairing his engine. The owner of the rescued yacht will in turn have a claim for redress against the miscreants under V.-3:105, but he will bear the risk of their ascertainment and of their ability to pay when successfully sued. However, V.-3:105 at least relieves the principal from the difficulty that a court could deem the intervention of the intervener for the purposes of liability in non-contractual liability for damage to be a *novus actus interveniens* or that an action for recourse based in the law on non-contractual liability for damage may fail for other reasons.

Illustration 2

For inexplicable reasons a toddler disappears from protected premises and runs on to the road. In order to avoid hitting the child, who suddenly appears in front of his vehicle, A steers away, but as a result of the consequent accident suffers injury. The child remains unharmed. A on principle has a claim against the child under V.-3:103 (Right to reparation). However, this claim will be reduced under V.-3:104(2) (Reduction or exclusion of intervener's rights), if and to the extent that A has a claim for reparation of damages vis-à-vis the nursery. Whether A in fact has such a claim is left to the general law on non-contractual liability for damage to decide. If there is no such claim, the child will have a claim for recourse against the nursery school arising from V.-3:105, if the nursery school would have been liable vis-à-vis *the child* if the latter had been hit by A's vehicle.

Rights in benevolent intervention and in the law on non-contractual liability for damage.

The provision proceeds therefore on the basis that the intervener has direct redress against the principal, to whom passes in turn the burden of identifying the appropriate wrongdoer. This provides the necessary protection for the intervener, commensurate with having sustained damage for altruistic reasons, because the principal rather than the intervener will carry the risk that the person who is ultimately responsible for the intervener's damage is unable to satisfy the liability to compensate.

Wrongdoer and intervener. The person responsible for the danger – the potential wrongdoer – might be the party rendering aid rather than a third party. As noted earlier, a person who has injured another and then sets about reparation of the harm caused cannot act as intervener in relation to the victim because, by the rules of the law on non-contractual liability for damage, the person causing the damage is obliged to compensate the victim for

the damage wrongfully caused. His act of “healing” the damage is a performance of the private law obligation owed to the victim and is thus excluded from benevolent intervention by V.–1:103 (Exclusions) sub-paragraph (a).

V.–3:106: Authority of intervener to act as representative of the principal

(1) The intervener may conclude legal transactions or perform other juridical acts as a representative of the principal in so far as this may reasonably be expected to benefit the principal.

(2) However, a unilateral juridical act by the intervener as a representative of the principal has no effect if the person to whom it is addressed rejects the act without undue delay.

COMMENTS

A. Third party relations

Three different situations. Where third parties are engaged there are three situations which are legally distinguishable, though in terms of everyday life they are relatively proximate. Firstly, there is the situation where someone intends to be active as intervener, but – for example, because lacking the necessary expertise – leaves the actual carrying out of the work to another, such as an employee or an independent contractor. The second basic situation is where one person (A) merely alerts another (B) to the fact that the principal (C) is in danger or otherwise needs help, A leaving it up to B to decide whether or not to intervene for the benefit of C. Finally, in the third basic situation A again turns to B, but this time concludes a contract with B (or effects a unilateral juridical act vis-à-vis B), but as a representative of C (i.e. in the name of C or otherwise in such a way as to indicate an intention to affect C’s legal position) but without being authorised by C to do so. V.–3:106 is concerned with only the last of these three situations.

Conclusion of a contract in the intervener’s own name and not as principal’s representative. In the first mentioned situation (where A concludes a contract with B in A’s own name, though for the purpose of benefiting C) only A is an intervener. The party taking up the commission (in our example, the employee or independent contractor) does not satisfy the conditions of V.–1:101 (Intervention to benefit another) (see further V.–1:103 (Exclusions) sub-paragraph (c)) and is accordingly not a benevolent intervener – not even in relation to the benefited party. In that regard the outcome is no different if the contract between A and B is so constituted that as a genuine contract for the benefit of a third party it confers rights on C against B. If the contract is so constituted as a genuine contract for the benefit of a third party, this merely furnishes a further reason for excluding B from the law of benevolent intervention, namely V.–1:103 (Exclusions) sub-paragraph (a). However, the intervener (the party giving the commission) of course remains obliged in relation to the principal, though having made use of another in order to fulfil the obligations.

Engagement of third parties without conclusion of a contract. There is no need for further rules either for the (second) case where someone, who has become aware of a danger threatening the principal, alerts a third person (once again, as a rule an independent operator) to the situation and abdicates to that third person the decision whether or not to intervene. If the third person steps in, then we are faced with two different measures taken (the invitation to act, on the one hand, and the actual carrying out of the preventative measures, on the other)

and therefore with two interveners who are completely independent of one another and two independent acts of benevolent intervention.

Conclusion of a contract as representative of the principal. Finally, the third question looks to whether an intervener may conclude a contract with a third party on behalf of the principal. This question is addressed in V.-3:106(1) and is answered here in the affirmative. The intervener may conclude contracts with third parties as a representative of the principal if in doing so the intervener is advancing the principal's interest appropriately. The intervener (A) in this situation, incidentally, is only the person who concludes the contract and not the third party (B), because B will provide the service to the principal (C) on the basis of a valid contract subsisting between B and C.

B. The intervener's power of representation

Considerations of legal policy. The European jurisdictions disagree on whether or not a power of legal representation should be conferred on the intervener. In Belgium, France and Luxembourg such a right is affirmed by CC art. 1375. The same is true for Italy, if the benevolent intervention has been "usefully" undertaken (CC art. 2031). In the Netherlands too a *gestor* is "authorised to carry out legal transactions in the name of the person concerned, in so far as the latter's interest is duly furthered thereby" (Dutch CC art. 6:201). In all other legal systems in continental Europe, by contrast, a justified intervener who acts in the name of the principal acts as an agent without a power of representation if there is no agreed mandate or power of attorney and the subsequent ratification (*ratificação*) of the principal is not forthcoming, albeit that this is only expressly set out in statute in Portugal (CC art. 471 sent. 1 in conjunction with art. 268). V.-3:106(1) proceeds from the basic idea that such a legally conferred authority does not impose an undue burden on the principal, but at the same time appropriately accommodates the interests of the intervener as well as those of third parties. The intervener who concludes a contract with a third party otherwise than as a representative of the principal is entitled to demand indemnification and reimbursement of expenditure from the principal (V.-3:101 (Right to indemnification or reimbursement)). Thus the principal will already have to bear the economic consequences: that is, will have to pay to the intervener the amount the latter is obliged to pay the third party. Thus from an economic perspective it does not make any difference whether an obligation is imposed on the principal to perform directly to the third party. The principal's position is by no means weakened. On the other hand the intervener benefits by being freed from liability under the contract with the third party provided the intervener acts within the scope of the legally conferred authority. The third party in turn must take action against the principal. This results in a reallocation of the risk of insolvency. Yet exactly this reallocation seems both appropriate and desirable since the third party knows that the intervener acts as a representative of the principal (see II.-6:105 (When representative's act affects the principal's legal position)) and is free to decide whether or not to accept the offer to conclude a contract with the principal.

Relation to the rules on representation in Book II. The rules on representation in Book II, Chapter 6 are not restricted to cases where the power of representation finds its basis in a voluntary grant of authority. "The authority of a representative may be granted by the principal or by the law" (II.-6:103 (Authorisation) paragraph (1)) (In the PECL Chapter 3 by contrast, the rules on agency did *not* govern an agent's authority bestowed by law (PECL art. 3:101(2)). Benevolent intervention is precisely an instance where a representative's authority is conferred by law. V.-3:106 grants authority itself and this makes up for the lack of any authority conferred by contract. The general requirement under the rules on representation that in order to affect the principal's legal position the intervener has to act in the name of the

principal or otherwise in such a way as to indicate to the third party an intention to affect the legal position of the principal remains unaffected (II.–6:105 (When representative’s act affects the principal’s legal position)). A juridical act effected in the intervener’s own name, and without indicating an intention to bind the principal, will bind only the intervener in relation to the third party (II.–6:106 (Representative acting in own name)). If the intervener acts in the principal’s name, but beyond the scope of the authority conferred by V.–3:106, the position is regulated by II.–6:107 (Person purporting to act as representative but not having authority).

Transactions covered. V.–3:106 (Authority of intervener to act as representative of the principal) paragraph (1) embraces legal transactions of all types. In particular it is not limited to the conclusion of a contract by way of offer and acceptance; it also covers unilateral declarations of the principal’s will (e. g. a notice to quit). However, V.–3:106(2) provides for a special rule in the case of unilateral acts. Self-evident (and therefore not mentioned as such) is the proposition that there can be no representation for strictly personal acts (see Comment B under V.–1:101 (Intervention to benefit another)). Whether and to what extent an intervener may undertake the conduct of litigation is, as already stressed in Comment B under V.–1:101, a matter for the law of procedure and is not decided here.

“In so far as this may reasonably be expected to benefit the principal”. A valid representation of the principal by the intervener may naturally only be considered if the general requirements set out in the first Chapter of this Book are met. Moreover V.–3:106(1) requires that the course of action chosen by the intervener, namely the making of an offer or other statement of intention *as a representative of the principal* must have been of such a nature as could reasonably be expected to benefit the latter. As may already be inferred from the general rules, conclusion of a contract by the intervener will as a rule only be considered justified for the purpose of temporarily stabilising a critical situation. V.–3:106 in addition demands that it must have been reasonable to expect that committing the principal to the third party would benefit the principal. This also applies to cases in which a representative appointed by contract is forced in the circumstances to act in excess of the contractual authority in order to advance the interests of the principal.

Illustration

B, the principal, is a celebrated public character, who visits another city incognito. As A knows, B suffers from a cerebral disease, which B has consistently concealed from the public due to reasonable concern for his career. Furthermore, B has good reason to conceal his presence in the city from the public. B is suddenly in urgent need of a hotel room for a few hours. A books this hotel room. It would not be reasonable to expect that concluding the contract in the name of B would be of benefit to B.

C. Unilateral acts (paragraph (2))

Third party protection. With respect to unilateral acts which the intervener does as a representative of the principal a further provision is necessary in order to protect the third party. It is contained in V.—3:106(2). In contrast to a conventional offer with a view to conclusion of a contract, a third party cannot simply ignore a notice of termination of a contractual relationship, or a notice of avoidance of a contract, or a measure interrupting the period of prescription or a notice by which an option is exercised or any comparable declaration which the intervener may effect in the name of the principal. Such declarations, if they are valid, modify the legal situation by themselves. Consequently the third party must be given some certainty. Thus paragraph (2) provides for the possibility to reject unilateral legal

acts which the intervener effects in the principal's name, provided the rejection is done without undue delay. It would be inequitable to impose on the third party the risk entailed in the fact that within a short space of time it may not be clarified whether the requirements of V.-1:101 for a valid benevolent intervention (and consequently a power of representation under V.-3:106(1)) were actually satisfied or not.

BOOK VI

NON-CONTRACTUAL LIABILITY ARISING OUT OF DAMAGE CAUSED TO ANOTHER

CHAPTER 1: FUNDAMENTAL PROVISIONS

VI.-1:101: Basic rule

(1) A person who suffers legally relevant damage has a right to reparation from a person who caused the damage intentionally or negligently or is otherwise accountable for the causation of the damage.

(2) Where a person has not caused legally relevant damage intentionally or negligently that person is accountable for the causation of legally relevant damage only if Chapter 3 (Accountability) so provides.

COMMENTS

A. The general approach

The basic rule in overview. Paragraph (1) contains a summary of the basic elements of non-contractual liability. It gives force to all the other Articles of this Book, none of which is complete in itself. This is expressed in VI.-1:103(a) (Scope of application). The present Article relates to the reparation of damage which has already occurred, while VI.-1:102 (Prevention) is concerned with prophylactic legal protection and compensation for expenditure incurred by someone for the purpose of preventing the occurrence of impending damage. Paragraph (2) of the present Article expresses one element of the basic rule in paragraph (1). It addresses the situation where the injuring person is liable in spite of having behaved perfectly correctly. Under such circumstances it will often be only certain defined types of loss which will be regarded as legally relevant damage – in particular personal injury and property damage. In so providing, paragraph (2) points ahead to the particular rules in Chapter 3, Section 2 (Accountability without intention or negligence).

Terminology: “tort” and “delict”. The choice of the expression “non-contractual liability for damage caused to another” (often abbreviated in the following pages to “non-contractual liability”) rather than “tort” or “delict” is easily explained. In the formulation of these model rules it was decided at an early stage to try to use descriptive language rather than technical terms from particular legal systems. Such technical terms often carry with them unwanted residues of a particular historical development and unwanted conceptual preconceptions and, partly for these reasons, can be notoriously difficult to translate. “Delict”, for example, carries with it a suggestion of wrongdoing, sometimes deliberate wrongdoing or even criminality. In its origin “tort” also suggests wrongdoing. This Book, as has just been explained, is not confined to wrongdoing. Moreover, “tort” and “tortious” are inextricably bound up with English law, while “delict” or its equivalent in other languages has different meanings in

different legal systems. “Tort” is short but that, sadly, is its only advantage. Brevity has had to be sacrificed, with some reluctance, for appropriateness and, in the broadest possible sense, translatability. Some other terms which were considered (like “civil responsibility”) would not by themselves, and when used in a new instrument without a background of shared understanding, have distinguished adequately between this branch of the law and other branches of private law.

Other terms. Some of the other terms frequently used in this Book are defined in Annex 1. The term “damage” has a wide meaning. It means any type of detrimental effect: it includes loss and injury. Not all damage is legally relevant damage for the purposes of this Book. The meaning of “legally relevant damage” – a key term – is explained below. The term “injured person” means a person suffering damage of any kind: it is not confined to a person who has suffered personal injury. Similarly, the term “injuring person” means a person causing or responsible for damage of any kind: again it is not confined to a person causing personal injury. A “claim” is a demand for something based on the assertion of a right. A “claimant” is a person who makes, or who has grounds for making, a claim. The words “claim” and “claimant” do not presuppose legal proceedings. This Book is concerned with the substantive law on non-contractual liability for damage. Most reparation claims are never the subject of legal proceedings. For this reason, and also because they are or were technical terms of particular legal systems, words like “plaintiff”, “pursuer”, “defendant” and “defender” are not used in this Book. Some other key terms (“economic and non-economic loss”, “reparation”, “compensation”, “person”) are, like “legally relevant damage”, discussed below.

The injured person’s perspective. Paragraph (1) is formulated in terms of a right and thus from the perspective of the injured person. That appeared a more straightforward approach than the one adopted in most of the current laws, which are constructed from the viewpoint of the injuring person. Furthermore, in the formulation chosen here the notion that liability for damage lies at the centre of this branch of the law is given more explicit expression. Finally, the formulation underlines the basic distribution of the burden of proof: the injured person must as a rule set out and prove all the facts founding the claim.

Economic and non-economic loss. The term “legally relevant damage” encompasses losses both of an economic and of a non-economic type, and in some cases injury as such. See further VI.–2:101 (Meaning of legally relevant damage) paragraph (1).

Damage and reparation. The basic rule draws a distinction between the concept of legally relevant damage and the reparation for that damage. The grounds of accountability (intention, negligence, and responsibility for a source of danger) are addressed in Chapter 3. They relate to the legally relevant damage (see in particular VI.–3:101 (Intention) and VI.–3:102 (Negligence)), which for its part may take the form of either an injury or a loss (stated in more detail in VI.–2:101 (Meaning of legally relevant damage)). The details on this point are to be found in Chapter 2. The form and amount of reparation and (in the case an infringement of an interest which is allocated to multiple parties) the question of the person or persons to whom reparation should be made are governed by Chapter 6. VI.–4:101(2) (General rule [on causation]) makes it clear that in the case of personal injury and death the predisposition of the victim is to be disregarded even if this could not be foreseen by the injuring person.

Reparation and compensation. The term “reparation” encompasses generically all legal redress which serves the function of making amends for a damage which has already

occurred. “Compensation” is used for reparation taking the specific form of a monetary payment. “Compensation” is therefore merely a special case of “reparation”.

Grounds of accountability. The provision brings together in one norm liability for intention, liability for negligence and liability where neither intention nor negligence on the part of the responsible person are a precondition. The expression “grounds of accountability” is used here as well as later as an umbrella term embracing both the potential for liability on account of intentionally causing damage or negligence on the one hand and the potential for liability on account of responsibility for a source of danger on the other. Forms of liability derived from rebuttable presumptions of negligence systematically still belong to the regime of liability for negligence. Certainly negligence in that case need not be proved, so that de facto there may be liability when the responsible person is not at fault but cannot prove that. However, liability is so constructed by the norms of the legal system that negligence in such a case is to be regarded as made out unless the contrary is proved.

Grounds of accountability and causation. The formulation also makes it explicit that where there is not even negligence, but the responsible person is nonetheless liable, it cannot normally be said that the responsible person has caused the damage. Rather that person is accountable for the causation of the damage. An example would be where an employer is vicariously liable for damage caused by an employee, but in the absence of a breach of the duty to supervise the employee it cannot be said that the employer caused the damage; it was the employee who caused it. Strictly understood, the requirement of causation therefore emerges in two different contexts: it connects (i) intentional or negligent conduct, on the one hand, and legally relevant damage, on the other, and it connects (ii) a source of danger for which a person is accountable by law (i.e. without intention or negligence) on the one hand and the damage resulting from the realisation of that danger on the other. This is the reason for the formulation of the second alternative of paragraph (1) (“or is otherwise accountable for the causation of the damage”). In the latter context accountability for an occurrence by which damage is caused stems in particular from the conduct of a person (in the example already given, an employee) or from a thing or an animal under the responsible person’s (ostensible) control. That a causal connection is required between the conduct of the person or the materialisation of the potential for danger inherent in the thing, on the one hand, and the damage sustained, on the other, is repeated in the provisions of Chapter 3, Section 2 and in Chapter 4.

Omissions. An express distinction between liability for positive acts and liability for omissions is not included because it is not required. These cases are not fundamentally distinguished either at the level of negligence or the level of causation (see further the comments to VI.–3:102 (Negligence) and VI.–4:101 (General rule [on causation])). Furthermore, omissions to act can also lead to the intentional causation of damage (on which point see the comments to VI.–3:101 (Intention)). Moreover, for liability imposed irrespective of conduct falling short of the required standard of care, any such distinction (i.e. between omissions and positive acts) as a starting point entirely misses what is at the heart of this form of liability. It operates independently of any conduct on the part of the responsible person.

Burden of proof. VI.–1:101 presupposes the basic rule that the injured person has to set out and, if need be, prove the requirements which have to be satisfied if there is to be a right to reparation. Exceptions from this basic and implicit rule on the burden of proof are specifically mentioned in the provisions which follow. By contrast, it falls to the injuring person to set out and prove the existence of a ground of defence. The basic rule consequently provides that

each side must set out, and as the case requires prove, the circumstances founded on by that side. That this basic rule has not been adopted in the express wording of the Article is explained by the fact that it is not limited to the law on non-contractual liability; the principle is of general application.

Natural and legal persons. Where the text speaks of “a person” or “another” or their cognates, or invokes similar formulations, then, so far as nothing else is expressly designated (as is done in VI.–2:201 (Personal injury and consequential loss), in VI.–2:202 (Loss suffered by third parties as a result of another’s personal injury or death) and in VI.–2:203 (Infringement of dignity, liberty and privacy)), these terms are always to be understood as meaning both natural and legal persons. See Annex 1 – “person” means a natural or legal person – and VI.–1:103 (Scope of application) sub-paragraph (b).

Liability under public law not covered. However, the liability of natural and legal persons subject to public law arising out of the exercise of a public function is not regulated; see VI.–7:202 (Public law functions and court proceedings). In VI.–5:201 (Authority conferred by law) in any case, however, there is a ground of defence if legally relevant damage is caused with authority conferred by law.

B. How the basic rule works

A single cause of action. According to the concept of this draft every claim to reparation under the law on non-contractual liability must satisfy the requirements of paragraph (1) of VI.–1:101(Basic rule). There are no exceptions. In every case it is necessary to assess whether (i) the claimant has suffered a legally relevant damage, (ii) there is a ground of accountability in relation to the person against whom the claim is made, and (iii) the damage has been caused by an act or omission for which that person must answer by reason of negligence or intention or responsibility for a source of danger.

VI.–1:103(a) (Scope of application). Furthermore, VI.–1:103(a) (Scope of application) makes it clear that VI.–1:101(1) must always be read in conjunction with the following Articles. (The reason why this provision is not to be found in VI.–1:101 itself is purely a matter of drafting: the rule also applies to VI.–1:102 (Prevention)). Those following Articles furnish in particular an exhaustive statement of what is to be understood by the terms ‘legally relevant damage’ (Chapter 2), ‘grounds of accountability’ (Chapter 3) and ‘causation’ (Chapter 4). VI.–1:103(a) also helps to entrench VI.–1:101 within the exhaustive regime built up by the further chapters of this Part. Liability under VI.–1:101(1) exists only as provided for by the following Articles - in particular, therefore, only in accordance with the provisions of Chapters 5 to 7. Thus it is settled that every one of the following provisions – and above all the provisions on grounds of defence and the consequences of liability – obtains its effectiveness only within the framework of the basic rule. The circumstance, for example, that a person has wilfully caused damage to another does not necessarily subject that person as a consequence to an obligation to make reparation. It is always open to that person to invoke one of the numerous grounds of defence, which incidentally are applicable generally to all three grounds of liability (and thus also to liability without intention or negligence).

No general clause. VI.–1:101(1) is thus on the one hand clearly a foundation for a claim. On the other hand it is not self-sufficient: rights are derived from it only with the aid of provisions beyond the confines of this rule, which is both fleshed out and limited by the following Articles. In other words, what we have here is not a general clause in the strict sense, but

rather a provision whose component elements are later filled out with more precise content. That does not exclude the prospect that, alongside others with sharply drawn contours, the following Articles may contain rules which have deliberately been left open and flexible. VI.-2:101 (Meaning of legally relevant damage) and VI.-4:101 (General Rule [on causation]) provide examples of this.

No liability beyond the boundaries of the following provisions. It is not possible to support liability on the basis of VI.-1:101 alone where this would extend beyond the boundaries pegged out by the following Articles.

Illustration 1

While parking her friend's (F's) vehicle in a car park, H damages O's parked car. In order to establish a claim against H under VI.-1:101, O must establish that (i) he has suffered a legally relevant damage, (ii) that H is accountable for it and (iii) either that H has caused the damage intentionally or negligently or that H is otherwise accountable for the causation of the damage. That follows from the wording of VI.-1:101(1). By virtue of VI.-1:103(a) (Scope of application), whether O has suffered a legally relevant damage primarily falls to be assessed under VI.-2:101(1)(a) (Meaning of legally relevant damage) in accordance with VI.-2:206 (Loss upon infringement of property). (The answer is, of course, affirmative.) As regards the issue of accountability, VI.-1:103(a) points to VI.-3:101 (Intention) or VI.-3:102 (Negligence). If we suppose that H did not mean to cause the damage, accountability would nonetheless be established if H failed to exercise the care required in parking the car. The analysis then turns in accordance with VI.-1:103(a) to causation, i.e. to VI.-4:101 (General rule [on causation]). The question which claims to reparation O is able to assert (and for what amount of compensation) is answered, in accordance with VI.-1:103(a), by the provisions of Chapter 6 and more particularly Section 2 of that chapter.

Illustration 2

The solution follows basically the same scheme if it is assumed (for whatever reason) that H has acted neither intentionally nor negligently. In this scenario, however, the question whether O has suffered a legally relevant damage must be assessed in accordance with VI.-1:101(2) by reference to VI.-3:206 (Accountability for damage caused by motor vehicles). The answer is in the affirmative because this case relates to property damage within the meaning of that provision. (VI.-3:206, as compared with VI.-2:206, invokes a narrower concept of legally relevant damage.) Finally, it must be established whether H is otherwise accountable for the damage (paragraph (1) of the basic rule). That question must be examined in accordance with the provisions of Chapter 3, Section 2 (Accountability without intention or negligence). The answer is in the negative because H is not a "keeper" of the car (VI.-3:208 (Control and use)). The claim would however be successful if directed against F as he is accountable for the causation of the damage by the motor vehicle. Whether O's claim ought to be reduced is a matter for VI.-5:102(4) (Contributory fault and accountability).

Illustration 3

The facts are as in illustration 1, except that H parked her own car and was not attending to her own affairs, but intended instead to make purchases on behalf of the F family, for whom she works as a childminder. In issue is the liability of Mr and Mrs F, neither of whom were negligent in the supervision of H. The test for legally relevant damage is the same as in illustration 1. That follows from VI.-1:101(2) in conjunction

with VI.-3:201 (Accountability for damage caused by employees and representatives), because this latter Article contains no particularities with regard to the presence of legally relevant damage. Mr and Mrs F have not caused the damage (that was done by H), but under VI.-1:101(1) (third limb: “*or who is otherwise accountable for the damage*”) in conjunction with VI.-3:201 that fact does not preclude liability. Mr and Mrs F are jointly liable under VI.-1:103(a) in conjunction with VI.-6:105 (Solidary liability).

Illustration 4

While out on a day’s shoot, J rests his loaded weapon, for a moment unattended, against a tree. A usurps possession of the weapon and fires off a shot. X is fatally injured and dies on the spot. Ascertaining non-contractual liability begins, as always and without exception, with VI.-1:101(1). X himself suffered no legally relevant damage. (The case would have been different if he died only after some interval of time, e.g. after admission at a hospital: VI.-2:201 (Personal injury and consequential loss)). The legally relevant damage suffered by those X leaves behind is determined by VI.-2:202 (Loss suffered by third parties as a result of another’s personal injury or death). As regards accountability, J has infringed either a statutory requirement to take care in handling weapons or a general duty to take care (VI.-3:102 (Negligence)). In determining that there was negligence it is immaterial whether J’s conduct is characterised as one of positive act (the placing of the loaded weapon in an unguarded location) or omission (failure to supervise the loaded weapon). However, J is not liable to those X has left behind for the damage suffered if A shot X intentionally and J had no reason to suppose that that sort of eventuality could happen (VI.-1:103(a) in conjunction with VI.-4:101 (General rule [on causation]: the murder cannot be regarded as the consequence of J’s negligence). The outcome would be no different if there were a strict liability for weapons (see VI.-3:207 (Other accountability for the causation of legally relevant damage)). In that case too the element of causation would still be missing.

Illustration 5

A is carrying out building work on her land which, on one particular occasion, results in a minor gathering of dust. A little dust settles on the car of B, a neighbour of A’s. B has no claim to reparation for the costs incurred in finding a garage with a car-wash facility; the damage is trivial (VI.-1:103(a) in conjunction with VI.-6:102 (De minimis rule)). Were repetitions of this incident with more pronounced collection of dust to be envisaged over a long term, B could then demand preventative relief (VI.-1:102 (Prevention) in conjunction with VI.-6:301 (Prevention in general)), according to the circumstances conceivably even a reasonable outlay at A’s own cost for the protection of the car against further soiling if another parking place is not usually available (VI.-1:102 in conjunction with VI.-1:103(a), VI.-2:206 (Loss upon infringement of property or lawful possession) and VI.-6:302 (Liability for loss in preventing damage)).

VI.-1:102: Prevention

Where legally relevant damage is impending, this Book confers on a person who would suffer the damage a right to prevent it. This right is against a person who would be accountable for the causation of the damage if it occurred.

COMMENTS

A. Prevention of impending damage

General. This Article makes it clear that preventative legal protection is also the concern of this Book. Prevention of damage is regarded as better than atonement for damage. At the same time the Article makes explicit one of the fundamental requirements of preventative protection of rights, namely the threat of damage. The second sentence pinpoints the person obliged to respect that right. All the other requirements of preventative protection of rights as well as limitations and particular forms of the right are the subject-matter of Chapter 6, Section 3 (Prevention).

Substantive law. The Article is formulated as a right based in substantive law and not as an instrument of the law of procedure. The entitlement to preventative protection of legal rights is consequently not a matter of judicial discretion. The Article furnishes a right no different in quality from the right under VI.-1:101 (Basic rule). Quite how as a matter of the law of procedure the right is to be enforced is not decided by these rules (see I.-1:101 (Intended field of application) paragraph (2)(h)).

Prohibition of damage and compensation for loss averting damage. VI.-1:102 is formulated in a manner corresponding to VI.-1:101. Whereas VI.-1:101 provides for a right to reparation, the various forms of which are fleshed out in the first two sections of Chapter 6, VI.-1:102 provides for a right to prevention whose particular forms are the subject matter of the provisions set out in the third section of Chapter 6. It follows from those provisions that VI.-1:102 does not deal only with a right to prohibit; it deals also to rights arising from one's own voluntary endeavour to avoid damage which, were it not for the injured person's intervention, would have occurred (or would have been exacerbated) and would have entitled the injured person to reparation. (see also VI.-6:302 (Liability for loss in preventing damage)). In this way it is made clear that under this Book cases of that type are absorbed within non-contractual liability law rather than the law of benevolent intervention in another's affairs.

Prevention and the law on non-contractual liability . Although VI.-1:102 is contained in the Book setting out the law on non-contractual liability, this does not amount to a definitive statement about whether preventative legal protection as a whole is to be considered part of this branch of the law , an independent area of the law or a part of other areas of the law (such as the law of property or the law of persons). The draft does, however, adopt the position that preventative legal protection forms a part of the law on non-contractual liability in so far as the person responsible for the threat of damage would be liable for the damage under VI.-1:101 (Basic rule) if it occurred. Further claims to restrain activities based on other legal grounds are unaffected: see VI.-1:103(d) (Scope of application).

B. Claimant and responsible person

Claimant. The beneficiary of the right conferred by VI.-1:102 is the person who would suffer the legally damage if its incidence is not prevented. Quite what counts as a legally relevant damage is to be assessed for the purposes of VI.-1:102 using the same framework of rules as applies in relation to VI.-1:101, namely in accordance with the provisions of Chapter 2. However, the draft does not purport to answer the question whether (and if so, in which circumstances) associations (howsoever legally constituted) are also beneficiaries of rights to restrain another's activities in the furtherance of collective interests and entitled to enforce

those rights through the courts. This relates in particular to organisations such as environmental groups, consumer associations, or other bodies concerned with prohibiting unfair competition or improper practices. Rights under VI.–1:102 may of course be held by persons who, had they caused damage, would not themselves be liable: a child abused by a step-father has a claim that such conduct be stopped.

Responsible person. The person liable to respect the claimant’s right to prohibition is someone who, were the damage to occur, would have been liable for its causation (called here the “responsible person”). Cases of this type presuppose in the nature of things an impending damage which can only be avoided by the removal of the danger which threatens to be a cause of damage. That danger normally emanates from a person who has acted or failed to act in the manner required in the circumstances.

Illustration 1

Owner of a vehicle O notices that a small child is working away at the paint on his car with a metal object. It may well be that the child is entirely unaware of doing any wrong and is therefore not liable under the law on non-contractual liability for causing the damage (see VI.–3:103 (Children)). However, O can insist that the child’s mother, standing nearby, exercise her influence over the child to stop the scratching of the car (cf. VI.–6:301 (Prevention in general)). The mother would act negligently if she closed her eyes to her child’s conduct. As to whether (and if so, how) O might have a claim directly against the child, see below at illustration 3.

Responsible person under strict liability. The responsible person may be someone who would be accountable without intention or negligence for the causation of the damage if it occurred. A prerequisite here of course is that the relevant judicial redress would be effective from a practical point of view. A genuine claim for prevention against someone who falls into the field of legal accountability merely because of responsibility for some risk will for that reason rarely come into question. The claim to reparation for a loss averting damage, however, remains unaffected.

C. Essential elements entitling the claimant

Impending damage. A prerequisite of every claim to prevention is an impending danger to an interest whose infringement would constitute a legally relevant damage. The danger has to be specific; there must be an immediate risk of legally relevant damage. Neither an abstract potential danger nor the endangerment of another suffices. No one, for example, has a claim against the manufacturer of an automobile that a particular component of the vehicle be constructed in a particular manner or that a defectively constructed vehicle be recalled from the market. A damage ceases to be impending, of course, when it has already occurred and there is no prospect of further damage. Similarly, there will as a rule be no threat of damage if the activity which is to cease does not allow of exact description. As regards the question when a right to prevention also embraces the right to require another to undertake certain positive measures, see the comments to VI.–6:301 (Prevention in general).

Aggravation of damage. The right to protection from impending damage is concerned not only with preventing the first occurrence of damage. It includes the right to stop the aggravation of damage which the injured person has already started to suffer. The text does not state that point expressly only because (i) it appears self-evident and (ii) a longer formulation would have made it necessary to repeat the formula in all the Articles in the first two sections of this Book.

Illustration 2

Without permission to do so, T heaves an extremely heavy object on to O's transport vehicle. Due to its sheer weight the object damages the vehicle when it is set down. The continued presence of the object in the vehicle threatens to cause further damage. O has a right of prevention in relation to the impending but avoidable further damage.

Protection of rights. Similarly the Articles make no express mention of the impending infringement (or threatened aggravation of an infringement) of an 'absolute' right or a legally protected interest. That was not necessary because the expression "legally relevant damage" embraces these positions worthy of legal protection: VI.-2:101 (Meaning of legally relevant damage).

Accountability. The claim is directed against the person who would be accountable for the causation of the damage if it occurred. From this it follows that the right contained in VI.-1:102 presupposes one of the three grounds of accountability of the responsible person set out in VI.-1:101 (Intention, negligence, or responsibility for a source of danger). That applies to VI.-6:301 (Prevention) as much as to VI.-6:302 (Liability for loss in preventing damage). From a merely factual point of view, there is as a rule no effective right of prevention in respect of aimless conduct or accidental happenings: the danger in such a case has almost always been fully realised when the damage is sustained. A conceivable exception is the impending worsening of a damage which was caused merely negligently. As regards the right of self-defence in relation to persons immune from liability see the comments below.

Restriction of the claim. The right to prevention is not unlimited; it has to be particularised and limited in many regards. Those limits are formulated in VI.-6:301 (Right to prevention) and VI.-6:302 (Liability for loss in preventing damage). VI.-1:103 (Scope of application) sub-paragraph (a) makes it clear that the Articles in Chapter 6 qualify VI.-1:102 in the same manner that they qualify VI.-1:101 (Basic rule) in the context of reparation.

D. Relationship to VI.-5:202 (Self-defence, benevolent intervention and necessity)

General. The avoidance of an impending damage is also the concern of VI.-5:202 (Self-defence, benevolent intervention and necessity). However, VI.-1:102 and VI.-5:202 differ from one another both in outlook and function. The effect of VI.-5:202 is that someone who causes another damage in the course of defending that person's own or another's property, person or other interests is not liable for that damage. VI.-1:102, by contrast, confers on a person who would suffer damage if it is not averted a right to prevention or, as the case may be, a right to reimbursement of the costs of protective measures. Both claims are directed against the person who would be accountable for the causation of the damage according to the provisions of this Book.

Persons incapable of being accountable for their causation of damage. It follows from this approach that VI.-1:102 is concerned with persons incapable of being accountable for their causation of damage only to the extent that one is confronted with the question whether such persons have a right against someone acting against them in taking measures to avert the damage which threatens.

Illustration 3

The facts are the same as in Illustration 1, save that in issue are rights vis-à-vis the child rather than the parent. O has neither rights under VI.–1:101 (Basic rule) nor rights under VI.–1:102 (Prevention) vis-à-vis the child. An answer to the question whether O may permissibly exercise direct control over the child (by oral command and, if need be, physical restraint) depends simply on whether the child has a right to prevent O's conduct. This is not the case because O has a ground of defence contained in VI.–5:202(1) (Self-defence, benevolent intervention and necessity). That is a sufficient response: there is no necessity from the point of view of non-contractual liability law to re-formulate this ground of defence as a general right of O's. Additionally O may have a right to prevention under property law. The latter remains unaffected by virtue of VI.–1:103 (Scope of application), sub-paragraph (d).

VI.–1:103: Scope of application

The provisions of VI.–1:101 (Basic rule) and VI.–1:102 (Prevention):

- (a) apply only in accordance with the following provisions of this Book;*
- (b) apply to both legal and natural persons, unless otherwise stated;*
- (c) do not apply in so far as their application would contradict the purpose of other private law rules; and*
- (d) do not affect remedies available on other legal grounds.*

COMMENTS

A. Sub-paragraph (a)

VI.–1:101 (Basic rule) and VI.–1:102 (Prevention) not self-sufficient rules. The significance and operation of VI.–1:103(a) have already been explained in the comments to VI.–1:101 (Basic rule). This provision serves the purpose of guaranteeing that neither VI.–1:101 (Basic rule) nor VI.–1:102 (Prevention) can be read as constituting self-sufficient rules. The content and meaning of the particular elements they invoke (legally relevant damage, accountability, causation, reparation and prevention) are to be drawn exclusively from the provisions of the following Chapters 2, 3, 4 and 6. Moreover, VI.–1:103(a) makes it clear that the provisions concerning defences (Chapter 5) and the matters left unaffected by this Book (Chapter 7) retain their significance in the application of VI.–1:101 (Basic rule) and VI.–1:102 (Prevention).

B. Application to legal and natural persons (sub-paragraph (b))

Legal persons as claimants. Where the Articles in this Book speak of “a person” or “another” or their cognates, or invoke similar formulations, then, so far as nothing else is expressly designated, these terms, as was already explained, are always to be understood as meaning both natural and legal persons. As regards the few exceptions to this basic rule a distinction must be made according to whether the legal person is a prospective claimant or a responsible person. In the first case there are special rules, confined according to the nature of things to natural persons, to be found in VI.–2:201 (Personal injury and consequential loss), in VI.–2:202 (Loss suffered by third parties as a result of another's personal injury or death) and in VI.–2:203 (Infringement of dignity, liberty and privacy). The question as to the extent to which the legal person may enjoy incorporeal rights of personality must consequently be decided on the basis of VI.–2:101 (Meaning of legally relevant damage) (see the comments to that Article and to VI.–2:203 (Infringement of dignity, liberty and privacy)). A further issue, moreover, is whether legal persons can suffer non-economic damage and on that account lay

claim to damages. This draft leaves no doubt about the matter: the question is to be answered in the affirmative (see, for more detail, the comments to VI.–2:101 (Personal injury and consequential loss)).

Legal persons as responsible persons. It follows from VI.–1:103(b) that a legal person is accountable for the causation of legally relevant damage basically in the same manner as a natural person. A few clarifications only are required. Firstly, legal persons are liable to third parties not only for damage caused by their employees; they are also liable for damage caused by their representatives. See VI.–3:201 (Accountability for damage caused by employees and representatives) paragraph (2). Clarification is necessary in the second place because legal persons may be subject to special duties of care – in particular the duty to organise their activities in a way which does not expose others to hazards. These duties are “located” in VI.–3:102 (Negligence). In other words, it follows from VI.–1:103(b) that a legal person too may act negligently or, as the case may be, intentionally within the meaning of VI.–3:101 (Intention): cf. comment B below. Thus its liability may be based on (i) its own intention, (ii) its own breach of duty, (iii) a breach of duty of its own representatives, (iv) a breach of duty by its (other) employees, and (v) its responsibility for one of the sources of danger set out in Chapter 3, Section 2 (Accountability without intention or negligence).

Bad organisation. The duties of correct organisation just mentioned are, purely from the nature of things, predominantly relevant to legal persons. However, in particular cases they may also come into play within the context of a sole trader’s business or comparable organisation.

Illustration 1

A sudden emergency case in a hospital cannot be responded to early enough because the appropriate doctor is overburdened in another department of the hospital and cannot get away quickly enough. Had the hospital’s activities been correctly organised, another doctor would have been present on the ward in question. The hospital is liable for the failure in its organisation. The case would not be decided differently if (as is admittedly rarely if ever the case) the hospital were operated by an individual rather than a legal person.

Legal persons under public law. These rules make no fundamental distinction between legal persons regulated by private law and legal persons regulated by public law. As a starting point the latter are subject to the same rules as legal persons regulated by private law. However, note must be taken of VI.–7:103 (Public law functions and court proceedings): this Book does not govern the liability of legal persons (or individuals) arising out of the exercise of public law functions.

Imputation of knowledge and state of mind of legal persons. A legal person has as such neither its own cognition nor its own will. On the other hand, actual and constructive knowledge, wilfulness and other aspects of state of mind provide elements for a multitude of prerequisites of liability (e.g. intention, negligence, and the definition of a keeper) and grounds of defence (e.g. contributory fault). For that reason clarification is needed that the state of mind and knowledge of persons by whom a legal person acts are imputable to the legal person. This rule is not explicitly taken up in this Book only because (i) it is also of significance well beyond the limits of non-contractual liability law and (ii) there is much to be said for characterising it as a principle of company law. The persons without whom the legal person could never engage in legal relations are its representatives (see the definition in VI.–3:201 (Accountability for damage caused by employees and representatives), paragraph (2)). It is immaterial whether the natural persons acting for the corporation are themselves liable or

not. Furthermore, the legal person is to be regarded as if the individual knowledge of each of the representatives were bundled together and at its call. It is therefore conceivable that a legal person is liable on the basis of intentionally causing damage, although the member of the board actually taking the critical step was not even negligent.

Illustration 2

A, a member of the board of an incorporated company, arranges for building material from supplier L to be used in construction work for the company's customer K. Board member B, who is responsible for procurement, had arranged for these building materials to be acquired - contrary to the firm's policy - under reservation of title. A was unaware of this and B, who had no knowledge of the shortage of materials at the building site, had not envisaged that the materials would be deployed at this point in time. As a result of the incorporation in the building work, L loses ownership of the materials. The legal person has committed an intentional infringement of ownership to the detriment of L.

C. The relationship of the law on non-contractual liability to other areas of private law (sub-paragraph (c) and sub-paragraph (d)); general

The principle of free concurrence of actions. VI.-1:103(c) and (d) regulate in two provisions the relationship of the law on non-contractual liability to other areas of private law. They proceed on the basis that generally an injured person can select from among the several bases of claim which come into consideration the one which seems the most advantageous. (The same holds correspondingly where, according to the applicable law of procedure and jurisdiction, the court is required to recognise the basis of claim relied on by the claimant). Where the claimant, for example, has a claim arising out of unjustified enrichment and out of the law on non-contractual liability, the former providing more extensive relief in the particular case than the latter, the law on non-contractual liability does not prevent the application of the law of unjustified enrichment (sub-paragraph (d)). The claim in respect of the unjustified enrichment, however, is not additional to the claim for reparation, but rather an alternative claim. (Similarly, where the enrichment is claimed *within* the law on non-contractual liability (see VI.-6:101(4) (Reparation)) this constitutes an alternative measure of redress to reparation, not an additional one.) However, in the converse situation (the non-contractual liability claim being more advantageous than the other claim) it may well be that the competing system – in particular the competing system for providing reparation - is an exclusive one, that is to say, the purpose of its rules is fulfilled only by ousting the law on non-contractual liability. Account is taken of that in sub-paragraph (c).

Preconditions of a situation of concurrent actions. The significance of the problem of concurrence of actions is occasionally overestimated. The problem only emerges if one and the same conduct falls under the provisions of two or more areas of the law, as an essential element of the claim, *and* that conduct is judged differently by those different provisions.

Illustration 3

No problem of concurrence of actions therefore emerges when a given non-performance of a contractual obligation does not in fact give rise to non-contractual liability according to the rules of this Book. Hence, for example, the mere failure to perform a contractual obligation to deliver goods at the correct time or of the correct quality is not covered by the terms of VI.-2:101 (Meaning of legally relevant damage).

Illustration 4

Similarly, no problem of concurrence of actions emerges where goods on hire are worn out, in accord with the terms of the contract by the hirer of the goods. That is because the act of the hirer is not merely not a failure to perform a contractual obligation; it does not even constitute an infringement of a property right relevant to the law on non-contractual liability since the destruction is justified by the consent of the lessor. The situation is different, however, if the law governing a contract of hire provides for a shorter limitation period for claims in respect of excessive destructive use of the goods than the law on non-contractual liability provides for a claim in respect of an intentional or negligent infringement of a property right. A problem of concurrence of actions likewise emerges if it suffices for liability under the law on non-contractual liability that the destruction was caused by (mere) negligence, whereas the claim under the law of hire turns on a more qualified measure of fault on the part of the hirer. In such a case the purpose of the provisions of the law on hire is such that they claim priority of application over those of the law on non-contractual liability (sub-paragraph (c)), since they would otherwise not achieve their intended effect, namely to protect the hirer from liability in the cases excluded by the more tightly framed rules.

D. Sub-paragraph (c)

Scope of application. The provision concentrates predominantly, but by no means exclusively, on the relationship between the law of contract and the law on non-contractual liability. It plays a similar role in relation to the law on benevolent intervention in another's affairs, the law of property and even family law. Consequently it does not matter whether it is a provision of autonomous private law or a provision of these rules which in accordance with its objective claims priority of application.

Illustration 5

It may well be, for example, that family law seeks to regulate in an exclusive way the legal consequences of a breach of duties of fidelity owed by married or engaged persons. In such a case the law on non-contractual liability would not be applicable if, following the disclosure of adultery, the cuckolded spouse suffers a severe nervous collapse with physical symptoms of the sort prescribed by VI.-2:201 (Personal injury and consequential loss). The situation is no different where family law provides for a less demanding standard of care between spouses or between parents and children than that applicable generally in the law on non-contractual liability. In that case VI.-1:103(c) has the effect that VI.-3:102 (Negligence) is rendered inapplicable.

Illustration 6

In the law of property too there are many provisions whose purpose is to exclude the law on non-contractual liability. For example, there are the rules on acquisition of title to property in good faith. Someone who according to the provisions of property law acquires ownership in good faith as a result of a disposition by a non-entitled party but in circumstances where a diligent person might have ascertained the absence of title in the disponent cannot be sued by the former owner to make reparation on account of a negligent infringement (destruction) of a property right. That would undermine the purpose of the provisions on acquisition of property in good faith - especially when consideration is given to a claim for reparation in kind. A right to restitution of the property on account of mere negligent infringement of the right of ownership would undermine the rule of property law whereby only (intentional or) *grossly* negligent disregard of the true owner's title prevents an acquisition. The point can be underlined in relation to nuisance: the basic rule on nuisance is to be found in the provision on

infringement of property rights, but the details regularly arise in the law governing and assigning rights between neighbours.

The law on non-contractual liability and the law of contract. As already indicated, however, the main area of application for the provision concerns the relationship to the law of contract. At the outset it must be appreciated that not every non-performance of a contractual obligation constitutes a non-contractual liability and nor is every non-contractual liability involving damage to a contracting party necessarily a non-performance of a contractual obligation. (A trivial example is where it just so happens to be the injured person's own employer who, on a Sunday afternoon, has caused damage by careless driving.) A second point of note is that these rules have not merely achieved considerable approximation of the rules on prescription applying to contractual and non-contractual rights but have also increasingly approximated the legal consequences of non-performance of a contractual obligation and non-contractual liability. In particular III.–3:701 (Right to damages) provides for damages for non-economic as well as economic loss resulting from non-performance of a contractual obligation. These developments have effectively diluted the practical significance of the problem of concurrence of actions. Where the law of contract and the law on non-contractual liability do in fact overlap, they only diverge from one another at the margins.

Priority of contract law in case of conflict. Should it, however, in fact come to a conflict between the values of contract law and non-contractual liability law in any particular case, whereby contract law denies liability which would subsist according to the provisions on non-contractual liability, then it is for the rules of contract law to assert priority if that is to be claimed in accord with the objective of the contract law rules. That is again the case if an application of the law on non-contractual liability in parallel with the corresponding contract law provision would deprive the latter of its effect. The contract law rule has priority so far as contract law actually claims it, whether expressly or merely by implication from the nature of things. Where contract law makes no such demand for the subsidiarity of non-contractual liability law, sub-paragraph (c) has no application and the principle of free concurrence of actions governs.

Illustration 7

III.–3:703 (Foreseeability) reads: “The debtor in an obligation which arises from a contract or other juridical act is liable only for loss which the debtor foresaw or could reasonably be expected to have foreseen at the time when the obligation was incurred as a likely result of the non-performance, unless the non-performance was intentional, reckless or grossly negligent.” In the commentary to this provision the following illustration (Illustration 2) is given: “Company S sells an animal food compound to B for feeding to pigs. B does not tell A for what breed of pigs the food is required. S negligently supplies a batch of the compound which contains a mild toxin known to cause discomfort to pigs but no serious harm. B's pigs are, however, of an unusual breed which is peculiarly sensitive to the toxin and after being fed with the compound many of the pigs die. S is not liable for the loss since it could not reasonably have foreseen it.” It would effectively annul the liability limiting function of this contract law provision if the provisions of non-contractual liability for property damage were to be applicable on these facts and with a contradictory outcome. It makes no difference, moreover, whether that non-contractual liability presupposes a negligence or not.

Illustration 8

Seller S sells to buyer B a concrete mixer. As a result of a defect in the mounting, the drum falls out of its anchoring on first use. Both the drum and the surrounding structure are deformed. B fails to make use of the right to terminate the contractual relationship within a reasonable time (cf. III.–3:508 (Loss of right to terminate). B

claims reparation for the damage to the machine on the ground that there has been an infringement of a property right as recognised by VI.-2:206 (Loss upon infringement of property or lawful possession). B would, let us suppose, be unable to recover damages for the non-conformity under contract law because of III.-3:107 (Failure to notify non-conformity). Moreover, consideration must be given to the fact that art. 9(b) of the EU product liability Directive encompasses only damage which is caused to a thing other than the defective product itself. That provision only concerns liability to consumers, but it invites the conclusion that the EU legislator generally wanted to leave cases of this type too to contract law. The priority of contract law can also be supported with the argument that in cases of self-destructive damage to goods after transfer of ownership there is no workable criterion for demarcating contractual and non-contractual responsibility and the legal system therefore always runs the risk of characterising a mere deviation of quality (and thereby also a core part of the law of sales) as a matter of non-contractual liability law. Under the system of these rules it may be that the question no longer merits any great attention. However, a consideration of the rules of general contract law, those of the law of sale and Art. 9(b) of the product liability Directive, taken together, justifies the conclusion that the law on non-contractual liability is not applicable to a buyer's claim to damages against a seller on account of self-inflicted damage to the goods acquired.

Illustration 9

Due to a doctor's error in treating a patient, the patient dies. There are no provisions in Book III specifically relating to legally relevant damage suffered by relatives in the case of a fatal personal injury. This silence on the part of Book III, however, is not an "eloquent silence" that speaks volumes in the sense that such claims are therefore to be excluded because the case is one of non-performance of a contractual obligation. The corresponding provision of the law on non-contractual liability for damage caused to another (VI.-2:202 (Loss suffered by third parties as a result of another's personal injury or death)) remains applicable. Within the non-contractual liability claim regard must also be had to VI.-6:203(2) (Capitalisation and quantification), VI.-7:105 (Reduction or exclusion of liability to indemnified persons), and even, depending on the organisational form of the hospital in the circumstances, VI.-7:103 (Public law functions and court proceedings).

E. Sub-paragraph (d)

The law on non-contractual liability does not oust other bases of claim. Sub-paragraph (d) concerns the converse situation: there is no valid claim which can be asserted according to the provisions of the law on non-contractual liability because, for example, there is no legally relevant damage or negligence or because the conditions for the liability for others are not fulfilled. In that case it is open to the claimant to pursue other bases for a claim which are more advantageous. This rule applies without exception and extends to the legal remedies available.

Illustration 10

Seller S has sold to buyer B land which is contaminated with oil residues. B has not suffered any infringement of a property right because the land was already contaminated at the time of transfer of ownership. A claim for damages for B against S under the law on non-contractual liability can therefore be contemplated only in the case of an intentional deception of B on the part of S (by an omission to make facts known) (VI.-2:210 (Loss upon fraudulent misrepresentation)). That of course does not preclude B from making use of contractual remedies available on account of S's non-performance of contractual obligations – in particular a contractual claim to damages.

Illustration 11

D is driving through a built-up area at an appropriate speed when a three year old girl suddenly steps into the road in front of him. He could not have foreseen that the girl would let go of her aunt's hand because she had spotted her mother on the opposite side of the street. D tries to avoid hitting the girl and collides with a tree. If he has no claim under the law on non-contractual liability, he can still assert a claim against the girl and/or the girl's parents under the law of benevolent intervention in another's affairs (see VII.-3:103 (Right to reparation)).

Illustration 12

A has registered a patent in respect of a certain industrial machine, but neither builds the machine nor undertakes any other efforts to commercialise the invention. Knowing of A's protected patent, B builds two machines of this type and sells them. A has suffered no substantial loss and therefore no legally relevant (patrimonial) damage. However, that precludes only a claim in non-contractual liability and does not prevent a claim being made in the law of unjustified enrichment.

No limitation to the law of obligations. Sub-paragraph (d) is in no way confined to the relationship to other parts of the law of obligations. Rather the provision makes it clear that the law on non-contractual liability fundamentally does not oust any claims based on other legal grounds. This can obtain practical significance in particular in relation to the law of property and so in relation to the law governing claims for preventative legal protection. So far as the law of property recognises a claim to a prohibitory or mandatory remedy to prevent (impending or continuing) damage which is independent of fault, such a claim may be asserted independently of the requirements of VI.-1:102 (Prevention). The same is true for preventative legal protection under the rules protecting trades, as for example under the Community trademarks regulation art. 98(1).

Special regimes relating to VI.-1:103(d). The following text features special regimes relevant to VI.-1:103(d) in three places, namely in VI.-2:203 (Defamation) paragraph (2), VI.-2:208 (Loss caused to a consumer as a result of unfair competition) paragraph (2) and VI.-3:207 (Other accountability for the causation of legally relevant damage). The former two relate to exceptional situations in which national law determines whether a legally relevant damage exists beyond that provided for by the express provisions of these rules. VI.-3:207, by contrast, refers to further instances of strict liability under national law. See the commentary to those Articles.

CHAPTER 2: LEGALLY RELEVANT DAMAGE

Section 1: General

VI.-2:101: Meaning of legally relevant damage

- (1) Loss, whether economic or non-economic, or injury is legally relevant damage if:*
- (a) one of the following rules of this Chapter so provides;*
 - (b) the loss or injury results from a violation of a right otherwise conferred by the law; or*
 - (c) the loss or injury results from a violation of an interest worthy of legal protection.*

(2) In any case covered only by sub-paragraphs (b) or (c) of paragraph (1) loss or injury constitutes legally relevant damage only if it would be fair and reasonable for there to be a right to reparation or prevention, as the case may be, under VI.–1:101 (Basic rule) or VI.–1:102 (Prevention).

(3) In considering whether it would be fair and reasonable for there to be a right to reparation or prevention regard is to be had to the ground of accountability, to the nature and proximity of the damage or impending damage, to the reasonable expectations of the person who suffers or would suffer the damage, and to considerations of public policy.

(4) In this Book:

(a) economic loss includes loss of income or profit, burdens incurred and a reduction in the value of property;

(b) non-economic loss includes pain and suffering and impairment of the quality of life.

COMMENTS

A. The function of the rule

Three pillars of legally relevant damage. This provision is essential in relation to the Chapters on damage (Chapter 2) and reparation for damage (Chapter 6). Its function, as the wording of paragraph (1) makes evident, is to erect a concept of “legally relevant damage” on three pillars. The first, envisaged in sub-paragraph (a), consists of all those particular forms of damage specifically provided for in the following Articles (of Chapter 2, Section 2). The other two are therefore those which are *not* specially mentioned in the following Articles. They relate to (i) infringements of rights and (ii) infringements of interests which are worthy of legal protection in terms of non-contractual liability. Beyond paragraph (1)(a), this provision finds application (and only finds application) when and in so far as the relevant legal question is not specifically addressed in the subsequent Articles of the Chapter.

Indications of legally relevant damage. All three ‘pillars’ of VI.–2:101, which together amount to the comprehensive definition of legally relevant damage, presuppose some grievance which, conceptually, is capable of being recognised as damage which is legally relevant. The function of VI.–2:101 is to indicate what forms of damage are, in given circumstances, legally relevant and so capable of establishing the rights set out in VI.–1:101 (Basic rule) and VI.–1:102 (Prevention). There must at the outset be some type of detrimental effect (see the definition of “damage” in Annex 1 – “any type of detrimental effect: it includes loss and injury”) but there is no need to define the sub-set of all possible harms, annoyances, disturbances to existing modes of living, or other adverse effects on welfare or future aspirations which, conceptually, may constitute damage. That is because what matters is the coincidence of detriment amounting to ‘damage’ with the further qualification that the ‘damage’ be legally relevant. All the necessary work which will eliminate irritations or disruptions for which no remedy is due can be achieved by focusing on the requirement that the damage (if such it is) must also be legally relevant. At the same time, as is done in the definition of “damage” in Annex 1, it must be clear that as a matter of principle loss as well as injury may amount to damage. What matters is whether that damage is legally relevant and, unless specific provision is made otherwise, it will be if it satisfies the requirements of VI.–2:101.

Forms of legally relevant damage: loss and injury. Legally relevant damage may take the form of either a loss or an injury as such. The starting point must be that damage presupposes a loss, but, as emerges from the following provisions, that does not constitute an invariable

rule. Whether the victim has suffered a damage *per se* because rights or interests have been violated is as a rule specified by the following provisions (see in particular VI.–2:201 (Personal injury and consequential loss) and the comments to that Article). With regard to its own field of application VI.–2:101 does not by itself determine whether injury as such is sufficient or whether it is only consequential losses which amount to damage. Hence a judge who, in an exceptional case, is compelled to fall back on VI.–2:101 must decide that question simply on the basis of that provision. It will only be in very rare cases that a judge will be confronted with that necessity, but it is a possibility which cannot be excluded. A situation in point would be where an athlete is wrongly disqualified from participating in an Olympic games as a result of a drugs test which was carried out incorrectly and the athlete, soon to be past peak physical condition, will never again be in a position to compete in an international event of such calibre. Whether this detriment is to be characterised as an injury and whether a monetary reparation is due must ultimately be decided by a judge by applying paragraphs (2) and (3).

Loss includes non-economic loss. A loss may be either of an economic or of a non-economic nature, see paragraph (4). As a basic rule both forms of loss are in principle compensatable. Precisely which losses constitute non-economic losses, however, is not conclusively stated by the draft – in keeping with the tradition of most of the national legal systems. The multitude of possibilities life assumes and the variety of circumstances which must necessarily be weighed up in the balance are much too numerous and diverse to be encapsulated in an exhaustive definition. Paragraph (4)(b) confines itself to declaring that “non-economic loss includes pain and suffering and impairment of the quality of life”. On the other hand, the text of the Article puts beyond doubt the proposition that legal persons (and not just natural persons) are capable of sustaining non-economic loss and demanding reparation on that account.

Interests without a market value. An economic loss is characterised by the fact that the harmed interest has a market value which can be assessed according to the economic rules of the market. Damage which is not economic in nature (such as bodily pain) can only be given a monetary equivalent by judicial decision. The same holds for injuries as such (as in the case of loss of a limb).

Quantum of loss. VI.–2:101 has the sole purpose of setting out the circumstances in which damage relevant to the law on non-contractual liability can be said to be recognisably present. On the other hand, the quantum of the loss, leaving aside for a moment the *de minimis* rule in VI.–6:102 (*De minimis* rule), is without significance for the question whether a legally relevant damage is present. It becomes relevant only in the matter of determining appropriate reparation, not least in determining what if any sum the liable person should pay by way of compensation.

B. The flexibility of the rule

Multiformity of life. The residual, flexible provision governing ‘legally relevant damage’ not specifically enumerated in Section 2, which constitutes the bulk of the subject-matter for VI.–2:101, is required not merely because it is impossible to capture the multiformity of life within a set of rules without employing some such open-ended clause for matters which the legislator cannot foresee. It is also indispensable for two further reasons.

Constitutional issues. The first is that there are some legal issues whose resolution and further development are best left by a European legal text to the courts, especially when regard is had to constitutional peculiarities in the individual jurisdictions (see also in this context VI.–7:101 (National constitutional laws)). An example is provided by the question whether and in what circumstances a parent’s obligation to maintain a child, which both parents, or at any rate one of them, did not want, constitutes damage recognised by the law on non-contractual liability. Another is whether a child, whose predisposition to some abnormality has been overlooked by the gynaecologist, can demand reparation on the ground that he or she would have been aborted. A third example is provided by the question of so-called *post-mortem* protection of a right of personality which is unknown in some legal systems (e.g. no defamation after death in the Common Law) and granted in others with the justification that it follows from the constitutional basic value of protection of human dignity. A fourth example is the question whether legal persons too enjoy a right of personality derived from basic norms (i.e. whether a legal person has a “reputation” or “dignity”) and, if so, how far its protection extends. In so far as an interest is recognised by the European Convention on Human Rights as a basic right in relations between state and citizen, that value judgement at any rate must be fed directly into the application of VI.–2:101 for the purposes of ascertaining legally relevant damage within the meaning of the law on non-contractual liability.

Underlying issues not yet harmonised. The second reason is that a European law on non-contractual liability can only pave a course for itself in many marginal areas step by step. An example is provided by the infringement of so-called “subjective” rights which enjoy protection against everybody and which are therefore often called “absolute” rights. That loss consequential to the infringement of such a right constitutes damage in a case where this results from negligence is generally accepted; it is thus possible for a European law on non-contractual liability to articulate this rule. By contrast, it is not possible for a European law on non-contractual liability by itself to harmonise the underlying issue (on which non-contractual liability for infringement would be parasitic) of whether or not such a subjective right exists. One thinks here, for example, of the so-called right to a name: whether there is such a right must in the end be decided by the relevant law of persons and as long as that is not harmonised there can be no harmonised law on non-contractual liability in relation to the infringement of a right to a name. It also follows that a uniform text on the law on non-contractual liability may still lead to divergent solutions in particular areas. That is neither avoidable nor unusual in European law-making, nor exactly a particularity of the element of damage in the non-contractual liability system. A comparable phenomenon also exists, for example, in relation to negligence committed by breach of a statutory duty because statutory duties may have different content not merely from country to country, but also nowadays from place to place. Another example from the sphere of infringement of rights is the so-called right to one’s own image and the right to one’s own voice. Reference in this context to the constitutionally based protection of rights of personality are obvious.

C. Violation of a right otherwise conferred by the law (paragraph (1)(b))

Scope of application. As is immediately apparent from paragraph (1)(a) and as we have already explained (see *supra* comments under VI.–1:101 (Basic rule)), it is only possible to have recourse to paragraph (1)(b) if there is no exhaustive regime for the case provided for in the following Articles of this Chapter.

Illustration 1

A is a member of an association of professionally active surveyors who are engaged to value land in connection with sale negotiations and applications for credit from banks. A's criticism, from a professional standpoint, of the association's board has placed him in dispute with that board. His membership is terminated as a result on a specious pretext and his name therefore ceases to appear on the publicised list of members. A suffers a substantial reduction in professional engagements. Since there is no legally relevant damage within the meaning of VI.-2:208 (Loss upon unlawful impairment of business), the judge must fall back on VI.-2:101(1)(b) to reach the result that A's membership right has been infringed and the loss of income caused in this way constitutes a legally relevant damage. Even if the judge should find that under the applicable law membership of the association does not constitute a "right" which operates *erga omnes* the judge will nonetheless have to decide on the basis of paragraph (1)(c) in A's favour. That is because an interest worthy of legal protection has been infringed in any event.

Illustration 2

W and H are obtaining a divorce. Custody of their child is granted to W; H has only contact rights. H is unable to accept this outcome and abducts the child. W has to engage a private detective to help find the child. The cost of doing so is a legally relevant consequential damage arising out of the infringement of a right (the right to custody or the right to provide parental care, however it may be described in the applicable family law) for which the following rules make no special provision.

Illustration 3

A damages a car which B has bought from C subject to reservation of title, the instalments of the purchase price remaining fully unpaid. VI.-2:206 (Loss upon infringement of property or lawful possession) is relevant not merely to the liability to C, but also to the liability in relation to B. There is no cause to resort to VI.-2:101(1)(b) because B too had a property right in respect of the car either in the form of a protected right of prospective ownership (cf. *Anwartschaftsrecht*) or based on his right of lawful possession, depending on the applicable law of property. The situation is no different if A crashes his car into B's house which is subject to a mortgage in favour of a bank. The bank's property right is damaged. However, the questions of who in such a case may demand reparation, in what measure and to whom it must be rendered belong, from a systematic point of view, in the Chapter on remedies (Chapter 6) and not in the Chapter on damage (Chapter 2). See further VI.-6:104 (Multiple injured persons).

Rights and interests worthy of legal protection. The Article distinguishes in paragraph (1) sub-paragraphs (b) and (c) between infringement of rights and injury to interests which are worthy of legal protection. For both of these alternatives the limitations and particularisations contained in paragraphs (2) and (3) apply. For that reason the practical significance of the distinction between "rights" and "interests which are worthy of legal protection" is not especially great. It has little significance because, as indicated already, the legal penumbra of the law on non-contractual liability is not yet harmonised and therefore the European legal systems may have completely diverse perceptions of what qualifies as a "right" and what is merely an "interest worthy of legal protection". The distinction is therefore perpetuated here primarily because the concept of infringement of a right is a familiar one in many (though by no means all) European jurisdictions. A secondary consideration is that in this way a certain gradation can be reached: a judge will be relatively more cautious in affirming a legally

relevant damage if only sub-paragraph (c) presents itself for that purpose. It is, however, important that the concern here is with rights and interests which enjoy protection against all comers and which therefore are generally capable of being infringed by anyone. A mere contractual interest in some performance, for example, is excluded from the scope of application of VI.–2:101 for this reason alone.

Rights otherwise conferred by the law. As regards the rights referred to in sub-paragraph (b), we are concerned here with rights which have already been assigned to the claimant by other parts of the legal system with the purpose that the claimant may resist their infringement. To the extent that a national legal system recognises the concept of “absolute” rights, all of the rights so qualified by it will constitute “rights otherwise conferred by the law” within the meaning of paragraph (1)(b). Moreover, these rights need not be rights within private law. A right to vote in an election, for example, is a “right” within the meaning of paragraph (1): it is a potential basis of non-contractual liability for one person to intentionally obstruct another from casting a vote in a public election. The same holds for the right not to be discriminated against on the grounds of sex or ethnic or racial origin by hoteliers, banks and others trading openly with the public. In cases of the latter type, though, there will often be an infringement of the right to respect for personal dignity, given specific expression in VI.–2:203 (Infringement of dignity, liberty and privacy). (See also II.–2:101 (Right not to be discriminated against) and II.–2:104 (Remedies).)

Purely contractual rights are, as a rule, excluded. On the other hand, purely personal “bilateral” rights, such as, for example, claims arising from a contract against the other contractual partner, are, as a rule, excluded. One exception to this is set out in VI.–2:211 (Loss upon inducement of breach of obligation). As regards the relationship between the law on non-contractual liability and the law of contract see further VI.–1:103 (Scope of application) and the comments on that Article.

D. Violation of an interest worthy of legal protection (paragraph (1)(c))

Significance of the provision. Paragraph (c) gives expression to the principle mentioned earlier that the law on non-contractual liability is not an ancillary area of the law in the sense that it can only grant legal protection where the claimant is adversely affected in a legal position whose worthiness for legal protection is already immediately ascertainable from the other provisions of the legal system. Rather, the law on non-contractual liability also determines autonomously what detriments in this context qualify as legally relevant damage.

Illustration 4

A, a married man, is severely ill with cancer and must contemplate his demise in the near future. The married couple would still like to have a child and A provides sperm which is deep-frozen pending a later *in vitro* fertilisation. A technician in the laboratory where the sperm is stored destroys it when she confuses test tubes. It would be difficult to argue that this is a case of personal injury within the meaning of VI.–2:201, nor can the matter be subsumed without force under VI.–2:203 (Infringement of dignity, liberty and privacy). An interest worthy of legal protection has been violated.

Responsibility of the courts for the development of the law on non-contractual liability. Sub-paragraph (c) in paragraph (1) effects the basic rule that legally relevant damage is also present where an interest is violated which is worthy of protection by the law on non-contractual liability. In view of the multifarious forms life takes, such an “open” clause is indispensable and, moreover, present in most of the European legal systems. Furthermore, the

provision also consciously makes space for the further development of the law on non-contractual liability by judges. It also avoids setting down in legislated form certain developments and concepts which are presently still in a state of flux. An example of the latter is liability for the loss of a chance. The problem is not merely best addressed at various points within the system of liability law; from a contemporary perspective it can also be said that the task of finding a solution is best delegated to the courts. Paragraphs (2) and (3) provide them only with certain guidelines.

E. Paragraphs (2) and (3)

Application to rights and interests worthy of legal protection. According to paragraph (2) a legally relevant damage only exists in cases of violation of a right or an interest if it is fair and reasonable to grant the claimant a right to reparation or prevention under VI.-1:101 (Basic rule) or VI.-1:102 (Prevention). Paragraphs (2) and (3) will have their main field of application within the framework of paragraph (1)(c), but they are not restricted to that. They also apply in cases of infringement of rights. In those cases too a weighing-up of interests cannot be entirely avoided. That is evident when one looks, among others, to the case already mentioned of an infringement of a right to a name: such conduct triggers liability (if at all) only when it is perpetrated in certain ways. More particularly, it may turn out that only preventative legal protection and not a right to reparation comes into question because while a legally relevant damage is present it does not also constitute a ‘reparable’ damage.

Illustration 5

On a poster are a number of far-right political slogans including the assertion that the genocide of millions of Jews in the Nazi concentration camps is a Zionist conspiracy. The sole surviving descendant of a man murdered in Auschwitz may demand on the basis of his ancestor’s *post-mortem* right of personality (so far as such a right is recognised by the applicable legal system) that the objectionable poster be taken down. A claim for reparation of non-economic loss may be dismissed by the judge on the basis of paragraph (2).

The balancing process in ascertaining an interest worthy of legal protection. The text in paragraphs (2) and (3) equips the judge who must decide whether an interest worthy of protection by the law on non-contractual liability has been infringed with several hints. An essential factor in this decision is the remedies side of the liability equation: the legal protection which is sought must be fair and reasonable (paragraph (2)) and the decision on that point depends *inter alia* on whether the case presented is one of intentionally inflicting damage, negligence or strict liability (paragraph (3)). Since the connection between a given form of strict liability and legally relevant damage is set out in most of the provisions of Chapter 3, Section 2 (Accountability without intention or negligence), paragraph (3) in fact only has practical significance for vicarious liability under VI.-3:201 (Accountability for damage caused by employees and representatives). Apart from VI.-3:207 (Other accountability for the causation of legally relevant damage), none of these Articles uses the term “legally relevant damage”, and in the context of VI.-3:207 the term is left to be fleshed out by national law. VI.-2:101(2) and (3), however, can have a role to play in the context of VI.-3:103 (Persons under eighteen) or VI.-3:104 (Accountability for damage caused by children or supervised persons).

The ground of accountability. The question whether a defined detriment constitutes a legally relevant damage often depends on the nature of the conduct which has caused the damage – in particular whether the injuring person has acted intentionally or merely

negligently. For example, there is a *legally relevant* damage only in cases of intentionally inducing non-performance of a contractual obligation (see VI.-2:211 (Loss upon inducement of non-performance of obligation)); a merely negligent enticement not to perform cannot create liability for want of a corresponding obligation not to interfere in that way and therefore consequently because there is no damage. Intentionally permitting the continuation of a detriment suffered by another may also signify in given circumstances an independent damage in the legal sense. An example would be when, without any want of care, someone has communicated incorrect information about another and they intentionally and with a view to causing damage leave the affected individual ‘in the lurch’ instead of making an appropriate correction without undue delay, although subsequently informed of the inaccuracy and despite such correction being possible. This type of damage may assume a more specific form where it amounts to infringement of a natural person’s right to respect for personal dignity (VI.-2:203 (Infringement of dignity, liberty and privacy)).

Illustration 6

Through his careless failure to maintain a safe distance between his vehicle and the car in front, A causes a traffic accident, which in turn leads to a traffic jam. A commercial agent (H) is caught up in the queue of traffic and misses a business appointment, in consequence of which she suffers a loss of income. Neither an infringement of a right of the commercial agent nor the violation of a legally protected interest comes into play. Such types of obstacles are part and parcel of the everyday risks of life. The situation would be different, however, if A had caused the accident in order to hold up his competitor H. In that case H would suffer a legally relevant damage.

Nature of the damage. Moreover, the type of detriment suffered and the considerations involved in causation play a role. (In illustration 6, for example, it would make no difference if one argued that legally relevant damage is present but A did not cause H’s loss.) There is a whole series of detriments which one has to accept without reparation even where it cannot be said that they are trivial within the meaning of VI.-6:102 (De minimis rule). An example expressly catered for in the following provisions is to be found in VI.-2:201 (Personal injury and consequential loss) paragraph (2)(b) (“personal injury includes injury to mental health *only* if it amounts to a medical condition”). Of course, the nature of the damage suffered also plays a substantial role besides this. There are interests, for example, which are in essence only assigned to the commonalty as a whole and therefore are not capable of constituting a legally relevant damage in relation to any particular individual. An example would be the loss of quality of life which is inflicted on residents in a given region because as a result of an industrial accident they are no longer able to enjoy the spectacle of particular wildlife, be it animals or plants, affected by the pollution (see VI.-2:209 (Burdens incurred by the state upon environmental impairment)).

Damage suffered in business competition. In a free market, which thrives on competition, market participants are not merely not allowed to seek to squeeze the market shares of their competitors by improper means. It would amount to a prohibited cartel to come to an agreement with competitors not to enter into competition with one another (or, to formulate it another way, not to inflict damage on one another). Loss suffered in fair competition is thus not legally relevant damage. Consequently, whether damage in the legal sense is present may depend solely on the internal viewpoint of the injuring person. For example, a person who resells goods below their purchase price is usually just making bad bargains which harm only that person’s own economic interests; but someone who undertakes the same activity with the purpose of driving competitors out of the market causes them legally relevant damage. It

remains a pre-condition, of course, that the competitor is not engaged in an illegal market. The 'business activity' of a pimp or a heroin dealer does not inflict legally relevant damage on rival criminals in the same sordid trade.

Proximity of damage. Also inextricably interwoven with one another on occasions are the concept of legally relevant damage and considerations of causation. That inheres in the nature of the matter and affects the entire perspective. If, for example a partner in an association of tax advisers breaches a (contractual or statutory) prohibition on competition in relation to the fellow partners and subsequently the turnover in the partnership falls off, but as part of an economic cycle and not due to the breach of the prohibition, then there is not merely a lack of causation: there is also no legally relevant damage. The situation would be no different if a doctor makes a false diagnosis, but that has no adverse effects because the progress of the illness could not have been resisted to better effect if the correct diagnosis had been made (e.g. because the treatment would have been the same, or because the treatment rendered did not exacerbate the real illness and it was in any case, at the time of the false diagnosis, too late to render an effective treatment). In cases of this type it is of course traditional for liability of the doctor to be rejected on the basis of a want of causation rather than the absence of a breach of duty or of damage and these basic rules do not alter anything in that regard. The example does, however, demonstrate how closely related these elements are since there is generally no duty to assist someone who cannot be helped and equally someone who is succumbing to such an illness is not suffering any damage which (from a liability viewpoint) is legally relevant.

Illustration 7

Equally, there is no legally relevant damage suffered when a person organises a concert with a particular singer about whose private life a newspaper has published incorrect information, so that the audience for the event is smaller than under normal circumstances. That is a risk which every organiser of an event must suffer; the damage is too remote and consequently not legally relevant in terms of liability. However, the singer herself suffers a legally relevant damage if her fee has been fixed by a formula based on turnover (VI.-2:204 (Loss upon communication of incorrect information about another)).

Reasonable expectations on the part of the injured person. A further factor is the reasonable expectation of the injured person. The concept mentioned earlier of liability for a lost chance – in particular the lost chance of being healed (though the point is not confined to this) – demonstrates this and is related to this consideration. At the same time it reiterates the point with clarity that ascertaining the existence of damage is often inseparably linked to the remedy which would be available for its reparation. It would be just as inequitable and unjust in those 'loss of a chance' cases to award compensation for 100% as it would be to award nothing at all. It is therefore not possible merely to state that a damage flows along a claim to reparation in its wake. Rather the position is that a legally relevant damage is only present so far and to the extent that the legal system is prepared to furnish the injured person with legal redress.

Considerations of public policy. Judgments of value concerning public welfare and the internal balance of the system of private law also play a role in ascertaining whether or not one is faced with a case of legally relevant damage. The mere non-performance of a contractual obligation (delayed performance, supply of defective goods, failure to transfer a promised debt, etc.) does not amount to a non-contractual liability because the legal system

contains its own preferential regime for these cases; it would be superfluous if one proceeded from the converse principle that every non-performance of a contractual obligation constitutes at the same time a non-contractual liability. However, other considerations of public policy also play a not insubstantial role. If someone is so bodily disfigured as a result of an accident that his spouse cannot endure life with him and they divorce, then ultimately only the answer to the question what stresses and strains a marriage can be expected to ‘endure’, according to contemporary views, is capable of resolving the question whether the economic and non-economic adverse consequences of the divorce amount to a legally relevant damage suffered by the immediate victim of the accident and his partner. It is precisely the same if the marriage breaks down because as a result of the accident the injured person has lost the capacity for sexual intercourse (that damage as such making out, of course, a legally relevant damage in accord with VI.–2:201 (Personal injury and consequential loss)). If the marriage remains intact on the other hand, then the *uninjured* spouse suffers a legally relevant damage since he or she is adversely affected in respect of an interest worthy of legal protection. Someone who only stands in a loose relationship to the injured person, however, does not suffer a legally relevant damage. In that latter situation there is merely an insubstantial reflected damage. Considerations of public policy, however, can also play a crucial role in a multitude of other cases.

Illustration 8

If he had given the factual and legal position even a halfway careful examination, A would have had to accept that his legal action against B could have no realistic prospect of success. The proceedings are dismissed with costs. As a result of having to attend to the legal proceedings, B has had to sacrifice time which he would otherwise have devoted to his (thereby partially neglected) business affairs. A legally protected interest of B is not affected. Were the case otherwise, A’s right to unimpeded access to the courts would not be assured.

F. Paragraph (4)

General. Paragraph (4) serves to make clear that the expression “economic loss” includes “loss of income or profit, burdens incurred and a reduction in the value of property” and that the expression “non-economic loss” “includes pain and suffering and impairment of the quality of life”. (The paragraph also serves to avoid unnecessary repetitions of these propositions in the following Articles.) As the use of “includes” indicates, these are not exhaustive definitions or closed lists. Mention is made only of the most important of the forms which these types of loss may assume. The provision makes no statement about the manner in which the obligation to make reparation is to be discharged or a compensatory monetary sum is to be assessed. Those questions are the province of Chapter 6 (Remedies) and, in part, Chapter 7 (Ancillary rules).

Significance of the distinction between economic and non-economic loss. Paragraphs (1) and (4) together minimise the significance of the (occasionally less than straightforward) distinction between economic and non-economic loss. Hence, for example, it is of merely academic interest whether (and if so, to what extent) the form of damage referred to in VI.–2:206 (Deprivation of the use of property) paragraph (2)(a) is a species of economic loss or of non-economic loss. In conformity with the general approach, here as in other instances both types of damage are reparable. A basic rule of the type to be found in some legal systems in Europe to the effect that non-economic damage does not generally support an entitlement to reparation and is only (exceptionally) reparable if statute expressly so provides is not a feature of these rules. Indeed some of these rules expressly apply solely to non-economic loss. By

contrast, VI.–2:209 (Burdens incurred by the state upon environmental impairment) refers only to “burdens” incurred by the State. That expression leaves no room for the contention that in such cases the State might assert a claim to recover for non-economic loss.

Economic loss. The existence of an economic loss is usually not difficult to determine. In the main this is determined by a comparison of the current economic position of the claimant (*status quo*) with that prevailing immediately before the allegedly damaging incident occurred (*status quo ante*) and ascertainment of a negative net balance. The economic loss is the difference between these two sums. This method of determining economic loss is of course particularly transparent in the case of a reduction in value of the victim’s property.

Increase in debts. An economic loss is also present, however, if the victim has damaged property repaired or if, following an injury to body or health, undergoes medical treatment. The economic loss in such cases consists of the increase in debts or outgoings which the victim has sustained in incurring an obligation to pay whoever was engaged to help eradicate or ameliorate the legally relevant damage. There are thus ”burdens incurred” by the victim. For the case where an inanimate thing is so severely damaged that the costs of its repair would exceed the market value it possessed before it was damaged (an economic “write-off”) VI.–6:101(3) (Aim and forms of reparation) provides a special regime.

Loss of income. A genuine ‘balance sheet’ comparison is an inadequate or impossible mechanism as regards the loss of rights which will only arise in the future, that is to say, rights which have not arisen in the interval between the damage causing event and its evaluation by the parties, insurers or the courts and which will only arise after this point in time. In accordance with all European legal systems, this Book expressly provides that a (future) loss of income or profit constitutes a reparable damage.

Other forms of economic damage. As already stated, however, the text does not exclude reparation for other forms of economic loss.

Illustration 9

A wife and mother (M) is so severely injured in a road accident that for a considerable period of time she is no longer able to provide domestic services in the family home. If M engages a home help, the latter’s wages, due from M, constitute for M an economic loss. Moreover, even if a home help is not engaged and the family decides to struggle through the difficult situation without outside assistance, there is still an economic loss. There is admittedly no “loss of income” because M was not remunerated for her domestic activity. Nonetheless M’s housekeeping has an economic value and its cessation constitutes a loss to M for which compensation is due. This result is compatible with the rule in VI.–6:201 (Injured person’s right of election) whereby the injured person can choose what to do with the compensation due.

Non-economic loss. Paragraph (4) lists in sub-paragraph (b) the most important forms of non-economic loss: pain and suffering and the impairment of the quality of life. These forms are, however, mere examples. Quite what other forms of impairment of emotional well-being constitute reparable loss must be decided by the courts. In doing so regard must be had in particular to VI.–6:102 (De minimis rule). Negative emotional responses such as annoyance, anger, disgust and repulsion which lie within the spectrum of normal, everyday feelings cannot suffice according to that provision. If the person concerned was driven to fear for his

or her life, on the other hand, then a non-economic loss has been suffered for which reparation would be recoverable if all the other elements of the non-contractual claim are made out.

Pain and suffering. Bodily pain and bodily suffering constitute the most obvious forms of non-economic loss. They are capable of being ascertained and evaluated relatively easily.

Impairment of the quality of life. Injuries to body and health can of course generate more than an immediate pain; there may be significant long-term reductions in the victim's quality of life as a consequence – for example, if the injured person is confined for the rest of his or her life to a wheel chair and is thus prevented from pursuing a favourite hobby, such as football. Such reductions in the quality of life may, however, have other causes. Typical examples are provided by infringements of incorporeal rights of personality (among others, incursions into spheres of privacy; derogatory statements which have as a consequence a negative impact on the social profile of the person concerned). Moreover, infringements of the right of free movement – imprisonment as such – also constitute a non-economic loss. The same is true for a spouse who himself or herself has not sustained any direct injury, but is compelled to accept a vacuous sexual life because his or her partner is no longer capable of sexual intercourse as a result of an accident.

Bereavement. Impairment of the quality of life relates to the objective loss of real possibilities for making the most of one's life. There is, however, a host of situations in which, objectively considered, such possibilities still exist, but subjectively their availability is no longer capable of being recognised. This too can constitute a non-economic loss. Bereavement following the loss of a close relative – more precisely, suffering as a result of the sudden emptiness in the life of the person left behind – constitutes a non-economic damage, even if this is neither an impairment of the quality of life nor pain and suffering in the narrow sense expressed in the Article. Bereavement relates to the consequences of an awareness that an impairment of the quality of life has arisen. It is a matter of self-limitation in the exploitation of life's opportunities due to the condition of mourning. Although, for example, a widow may have taken part in various social events and activities independent of her husband during his life, her mourning may induce her to pass up on these opportunities for social interaction as she becomes depressed and cuts herself off from society.

Other cases. Similar in structure are cases in which a woman loses her emotional capacity to establish an intimate relationship with a man as a result of suffering a sexual assault, or where a man's self-esteem is dramatically reduced because an accident has rendered him impotent. Furthermore, people suffer a non-economic loss if, as a result of the damage-causing event, they are forced to make a fundamental change in their chosen mode of living. That remains the case irrespective of whether an impartial third party might regard the newly adopted mode of living as qualitatively better.

Overlaps. It was considered undesirable to particularise pain suffered and loss of amenity in the text of the Article more precisely. Since these are non-economic damages, their assessment (and later quantification in a compensatory monetary equivalent) is necessarily a process involving a wide range of possible value judgements. There are also many cases in which a given detriment suffered by the injured person might be categorised as either pain or loss of amenity, not least because the constant suffering of pain is in itself the loss of the amenity to enjoy a pain-free life. For such reasons it would be better to leave any necessary subordinate refinement to the courts.

Section 2: Particular instances of legally relevant damage

VI.–2:201: Personal injury and consequential loss

(1) Loss caused to a natural person as a result of injury to his or her body or health and the injury as such are legally relevant damage.

(2) In this Book:

(a) such loss includes the costs of health care including expenses reasonably incurred for the care of the injured person by those close to him or her; and

(b) personal injury includes injury to mental health only if it amounts to a medical condition.

COMMENTS

A. Matters not regulated

Wrongful conception, wrongful birth and wrongful life. This provision deals with the most important aspects of the law governing liability for injury to body and health. Deliberately left unregulated, as indicated earlier (see comments under VI.–2:101 (Meaning of legally relevant damage)), are the extraordinarily problematic questions arising in the context of the birth of children which their parents (or one of their parents) did not want to have, whether it be for reasons of family planning or because the infant would have been aborted if the affliction had been recognised in time. The proposition that a child can be injured in the womb, however, is beyond all doubt. It is not material whether the child has even been conceived at the time of the act causing injury (e.g. in the case where a woman becomes pregnant *after* she has received an infusion of blood contaminated with a pathogen). As soon as the child obtains legal capacity, he or she has a claim against the person causing the damage, subject to the further requirements of the basic norm. Where, however, a child in the womb is so severely injured that a miscarriage or stillbirth results, the injury is to the mother's physical integrity and it is she who is correspondingly entitled to claim damages.

Detrimental impact on the quality of life without personal injury. VI.–2:201 concerns only injury to body or health. Adverse disturbance of the quality of life which does not result from such injuries can only be asserted as legally relevant damage on the basis of other rules in this Chapter – in particular on the basis of VI.–2:203 (Infringement of dignity, liberty and privacy) and, in part, VI.–2:204 (Loss upon communication of incorrect information).

Loss of chance. As already mentioned (see comments under VI.–2:101 (Meaning of legally relevant damage)), no specific mention has been made of loss of a chance, in particular the loss of a chance of being cured. At present no special rule can be stipulated here. This area is therefore left to the judiciary for future development. However, the general rule on legally relevant damage does leave room for characterising the loss of a chance as an independent form of damage for the purposes of the law on non-contractual liability (and not merely for the purposes of the law of contract: cf. III.–3:701 (Right to damages)); that is to say, the rule permits a departure from the strict “all or nothing” principle.

Quantum of damages. Questions as to quantum of damages are the subject matter of Chapter 6. That is nothing peculiar to the law governing personal injury and needs no special mention here. It should be noted, however, that these rules do not determine the manner in which compensation for personal injury and non-economic loss is to be quantified (e.g. exact figures for a claim for damages in respect of defined injuries, or amounts for each day's stay in hospital, etc.). See VI.–6:203 (Capitalisation and quantification) paragraph (2).

Type and mode of reparation. Equally, particulars concerning the type and mode of reparation (e.g. lump sum or periodical payment) are provided for in Chapter 6. The fundamental principles governing the necessary assessment of an emergent loss – in particular the loss of a future or hypothetical income – are by contrast to be derived from the relevant national (procedural) laws.

B. Damage to a person's body or health

Body and health distinguished. VI.–2:201 regulates the questions of identifying damage given the occurrence in fact of an injury to a natural person's body or health. The distinction between injury to the body on the one side and injury to health on the other has no great significance. Where an injury to the body is present, an injury to health will also be involved except in exceptional cases (e.g. the cutting or shaving of hair). It may also be noted that injuries to health concern disturbance to the internal bodily processes, while injuries to the body as a rule look towards interference with the external bodily integrity. Harassment (e.g. sexual harassment or harassment by unsolicited photography) does not fall under VI.–2:201; it falls under VI.–2:203 (Infringement of dignity, liberty and privacy) instead. By contrast, rape of course also constitutes a personal injury.

Injury to the person. With the exception of paragraph (2)(b) (mental health), the provisions do not specify any answer to the question when in a particular case an injury to body or health is present. As a rule, the existence of bodily injuries will be ascertained without difficulty. Every infringement of a person's bodily integrity is conceived by these Rules to amount to a personal injury. In this context too, however, regard must be had to VI.–6:102 (De minimis rule) (for example, where an intramuscular injection is being given and as a result of the nurse's clumsiness a small and harmless haematoma occurs, but nothing more serious happens). If an expectant mother is injured with the result that her child is stillborn this constitutes personal injury to the mother (and only to her; cf. above comment A).

Medical treatment; sports injuries. The question whether a person's body has been injured or not does not depend on the purpose of the interference with the bodily integrity. Medical operations and treatment constitute an infringement of bodily integrity even though they are for a beneficial purpose. Whether or not such treatment is allowed is decided by the patient on the basis of consent (see VI.–5:101 (Consent and acting on own risk)). The same is correspondingly true for sports injuries – in particular the injuries sustained in the course of participation in competitive sports (e.g. football, rugby) and more especially boxing and the martial arts, so long as these relate to the realisation of risks which are accepted simply on the basis of participation in the activity concerned.

Injury to health. In contrast, not entirely straightforward questions of demarcation may arise in the context of the concept of injury to health. One can consider, for example, noise nuisance resulting in a short-term headache and a multitude of other cases of diffuse departures from well-being. Here the decision in the particular case must be left to the judge.

The impairment of health must not be of a banal nature. On the other hand, severe injuries to health may already be present at a point in time at which the injured person's subjective sense of well-being is not yet adversely affected.

Illustration 1

A person suffering from the common cold who in going about daily life passes the illness on to another does not cause an injury to health.

Illustration 2

An AIDS infection, on the other hand, constitutes an injury to health from the time of contracting the HIV virus; the injured person does not have to wait until the disease itself has broken out. The same holds for other illnesses or diseases whose manifestation develops only over the course of time. What is admittedly required, of course, is that there is at least some form of illness which can be diagnosed. Asbestosis, for example, has a long period of incubation and occasionally it is not detectable over many years. An injury to health will be acknowledged in such cases – not least for the practical reasons pertaining to the submission of proof – only at that point in time when the illness can be diagnosed by competent medically-trained persons.

Related interests worthy of legal protection. In other cases it must be recognised that the denial of an injury to (body and) health by no means necessarily implies that no protection under the law governing liability is granted to the affected party. In this context one must recall the example of the spouse who loses the capacity for sexual intercourse as a result of an accident. The *other* spouse suffers thereby no damage to health, but they are still adversely affected in respect of an interest worthy of legal protection: see above comments under VI.–2:101 (Meaning of legally relevant damage). Further examples for VI.–2:101 are provided by the unauthorised extraction of organs from deceased persons (infringement of their *post-mortem* right of personality) or the improper use of bodily substances taken from living persons (blood, sperm taken for the purposes of insemination) which are not property and therefore not the subject of property law within the meaning of VI.–2:206 (Loss upon infringement of property or lawful possession).

Mental health. Paragraph (2)(b) merely stipulates a general basic rule for dealing with injuries to health taking the form of injuries to mental health. It is one of the provisions which in regard to the basic rule contain by way of exception a conclusive (“only”) definition. The problem of so-called nervous shock cases is deliberately addressed only partially. The further particulars remain left to the courts which must clarify them on the basis of the general rule of causation. Not every disturbance to the balance of mental and psychological well-being constitutes legally relevant damage. Rather injury must assume a condition which, according to the rules of medical science, can be diagnosed as an illness or complaint and which therefore calls for treatment (whether or not, according to the current state of medical science, treatment is in fact possible). In other words, psychiatric injury to health must amount to a medically ascertainable injury or recognisable condition. Precisely how such an illness is caused generally plays no role. What is decisive is only that it has been caused by conduct or an occurrence for which the injuring person is accountable. Provided the requirements of VI.–4:101 (General rule [on causation]) are satisfied, the legally relevant damage might take the form of damage to mental or psychiatric health, within the meaning of paragraph (2), which has its cause in the (well-founded) suspicion that an injury to physical health has been sustained.

Injury as such constitutes legally relevant damage. Paragraph (1) treats the injury as such as an independent head of legally relevant damage. That takes account of the fact that the

practical results of the concept of *danno biologico* have found increasing pervasive acceptance, albeit in various ways and with varied intensity. The physical injury is to be understood as damage in its own right, giving rise to its own entitlement to monetary compensation additional to and, as the case may be, independent of the existence of some economic or non-economic damage. According to the concept of the text, “injury as such” constitutes neither an economic damage nor a non-economic damage (the latter two being “losses” consequential to the injury), but rather falls into an independent category of its own. However, in quantifying monetary damages for some biological damage which has been suffered, it may well be necessary to put into the balance the other related heads of damage and weigh these up collectively. See also on this point VI.–6:204 (Compensation for injury as such), according to which “injury as such is to be compensated independently of compensation for economic or non-economic loss”.

Illustration 3

The cerebral injuries of the victim after an accident are so severe that he permanently loses his sensory capacity and sense of awareness. He has a claim to reparation for the obliteration of his personality, i.e. because of the injury *per se*, independent of the fact that he suffers no pain.

C. Loss

Economic and non-economic loss. Paragraph (1) extends to the injury as such and to all consequential loss. The word “loss” is defined in VI.–2:101(4) (Meaning of legally relevant damage) and embraces economic loss as well as non-economic loss. The most important forms of economic loss are listed in VI.–2:101(4)(a); the most important forms of non-economic loss are listed in VI.–2:101(4)(b). These rules apply also to VI.–2:201. As their wording indicates (“... loss includes”), they are not, however, exhaustive definitions. Rather they purport to do no more than list mere examples of typical economic and non-economic loss. Obviously further injury to health which results from an initially rather limited injury to the body or health is also a consequential damage. Moreover, there might be other consequential economic losses besides loss of income because the injured person is unable to attend to his or her affairs. An example would be the inability of a man or woman to provide domestic services at home. The fact that this activity is not remunerated dictates that there is no reparable loss of earnings, but that does not mean that there is therefore also no reparable economic loss. Consequential loss embraces a multitude of other economic losses – for example, the loss sustained when the victim is compelled as a result of the injury to sell his or her business at an undervalue or is unable to work and has to fall back on more expensive outside labour.

Cost of health care. Especially important in the context of injury to body or health are the “costs of health care” referred to explicitly in paragraph (2)(a). They include an increase in basic needs (e.g. the need to make use of a wheelchair). The concomitant multiplication of necessities required to support daily life (such as the expenditure which someone confined to a wheelchair must make in order to re-structure accommodation) also belongs to this category.

Loss of income. Loss of income (VI.–2:101(4)(a) (Meaning of legally relevant damage)), moreover, includes both loss of actual income and loss of future income. Falling in the latter category is the loss of earning capacity – not least of persons who, at the time of injury, were not in fact in gainful employment but who in all probability would have been in due course (e.g. children or young persons). The judge is granted further room for discretion in the interpretation both of the concept of “consequential loss” and the notion of “loss of income”.

In dealing with these the judge must also take into account the fact that the text recognises a further distinct category of damage in the form of “injury as such”.

D. Damage to the injured person and damage to third parties

Personal injury. As far as personal injury is concerned, the text does not draw any fundamental distinction between primary and secondary victims. This distinction is not helpful. That is because the decisive issue is always only whether the claimant has or has not suffered injury to his or her body or health. In the first case the claimant is a victim; in the second case not. Everything else is, within the framework of this Article, immaterial.

Illustration 4

A is so severely injured in an accident that she temporarily loses consciousness. She is thus unable to arrange for someone to deputise for her in providing the care, incumbent on her, required by a bedridden lady, L, whose condition of health deteriorates as a result. Whether L has a claim is determined by the rules on accountability and causation; that she has suffered a legally relevant damage within the meaning of VI.–2:201, by contrast, is beyond question.

Economic or non-economic losses of third persons. However, it is inherent in the nature of the matter that as a result of the injury of one person other persons may come to suffer damage of a different nature. Their damage need not be to their health (as in the above illustration), but may take other forms (e.g. damage to property, in which case VI.–2:206 (Loss upon infringement of property or lawful possession) would become applicable), and in particular the form of loss of support or mental suffering not amounting to a medical condition within the meaning of paragraph (2)(b). Where that is the case, the problem that arises is one addressed by VI.–2:202 (Loss suffered by third parties as a result of another’s personal injury or death) and not VI.–2:201. That is because VI.–2:201 only concerns damage suffered by the injured person, as indicated earlier.

Expenses of persons close to the injured person. There are, however, situations where it is difficult to say which losses qualify as damage suffered by the injured person and which are damage sustained by third parties. In respect of one problem which is important in practice paragraph (2)(a) (“including expenses reasonably incurred for the care of the injured person by those close to him or her”) provides an answer. This provision regulates a case at the boundary of so-called transferred loss (*Drittschadensliquidation*) which is not so easy to construe as a matter of law. The solution consists of assigning the expenditures of the relatives to the damage sustained by the injured person. As between these parties, the injured person is liable in turn to the relatives from the standpoint of either benevolent intervention in another’s affairs or unjustified enrichment.

Reasonable expenses of carers. The “expenses” of carers will not necessarily include the cost of sacrificing employment (e.g. foregone salary) in order to care for the injured person. An exceptional case is where the carer provides care as a matter of his or her profession (e.g. as a nurse), in which case the loss incurred by giving up remunerated work would ordinarily equate to the cost of paying someone to provide the same care. In other cases, recovery will depend on whether the loss of earnings of the carer are less than or exceed the cost of contracting for care. The expenses are recovered as part of the loss suffered by the injured person and in the latter case recovery in excess of the costs of nursing care will be barred because the injured person might have obtained care more cheaply. It should be noted that it will only be possible to speak of “care” provided by the attendance of visiting relatives, supporting the emotional well-being of the injured person in recovering health or providing comfort in distress, when the injured person is conscious and thus able to reap the associated

psychological benefit. The magnitude of the expenditure must be “reasonable”. This qualification is necessary for the protection of the liable person (and, correspondingly, that person’s insurer). An excessively frequent number of journeys to a remote special clinic where the injured person is being treated, for example, would not be reasonable.

Those close to the injured person. The injured person may only claim costs for those persons who are “close to him or her”. Decisive here is not a formal or legal familial relationship, rather that an emotional and special relationship exists between the carer and the injured person. The litmus test should be whether the person concerned is one whose presence at the bedside of the injured person is necessary for the advancement of the injured person’s convalescence or to stabilise his or her condition. This subgroup of people does not necessarily correspond to those people who under VI.–2:202 (Loss suffered by third parties as a result of another’s personal injury or death) paragraph (1) have a claim to damages for their non-economic losses sustained as a repercussion. The latter subgroup is more confined; a “particularly close personal relationship to the injured person” is the prerequisite here. If, for example, someone lives alone and therefore has no one who falls within VI.–2:202(1), it might well be that the sole surviving brother or only sister is called to the injured person’s bedside. Their travel expenses in getting to the hospital are recoverable, but, if the patient dies, the brother or sister in question has no claim to reparation for non-economic loss.

VI.–2:202: Loss suffered by third persons as a result of another’s personal injury or death

(1) Non-economic loss caused to a natural person as a result of another’s personal injury or death is legally relevant damage if at the time of injury that person is in a particularly close personal relationship to the injured person.

(2) Where a person has been fatally injured:

(a) legally relevant damage caused to the deceased on account of the injury to the time of death becomes legally relevant damage to the deceased’s successors;

(b) reasonable funeral expenses are legally relevant damage to the person incurring them; and

(c) loss of maintenance is legally relevant damage to a natural person whom the deceased maintained or, had death not occurred, would have maintained under statutory provisions or to whom the deceased provided care and financial support.

COMMENTS

A. General

Overview. This Article concerns a segment of the question which losses suffered by third parties as a result of the injury or death of another constitute for them legally relevant damage. The Article is concerned with the claims of close relatives and other persons who were particularly close to the injured person or, as the case may be, the deceased.

Persons not covered. Others having a relationship to the deceased (e.g. employers or employees, partners in a firm, etc.) may also be adversely affected by the death of the injured person and likewise suffer consequential damage. Whether or not such persons, in given circumstances, can have any claim against the injuring person will depend on the application of the residual rule on damage under VI.–2:101 (Meaning of legally relevant damage) paragraph (1)(b) and (c). It follows, however, by inference from the text of this provision that

persons who were connected with the injured person only in a business sense and not in a personal sense will only suffer a legally relevant damage in highly exceptionally circumstances. It is conceivable that they might be given a claim in cases of intentional killing with the aim of causing loss to the third party. The claim for labour or services which the employer had in relation to the party killed who was obliged to provide that service or those services does not amount to a “right” within the meaning of VI.-2:101(1)(b). It therefore depends on the circumstances listed in VI.-2:101(1)(c) whether or not the employer or business partner is injured in respect of an “interest worthy of legal protection”.

Illustration 1

A, one half of a couple of professional figure skaters, is injured in a road accident caused by C’s negligence. Because of the severity of his injuries, A is unable to skate for a while and consequently his skating partner B is unable to pursue her profession too. B has no claim under paragraph (1) to compensation for non-economic loss unless she was tied to B in a more than merely professional capacity on the basis of a particularly close personal relationship (as his spouse or cohabiting partner). Although it can be accepted that A and B are jointly exercising a profession or pursuing a trade within the meaning of VI.-2:208 (Loss upon unlawful impairment of business), a deliberate interference in the profession or trade is missing. A legally relevant damage can therefore only be made out within the scope of VI.-2:101 (Meaning of legally relevant damage). However, after consideration of all the circumstances, such an application of that provision to that effect must be rejected.

Non-economic losses. It follows ultimately from VI.-2:202(1) that third parties who are not referred to here do not have a claim to compensation for possible non-economic losses. Their opportunities to recover compensation are confined to economic losses (if any).

Structure and organisation of the rules. Paragraph (1) relates to non-economic losses of dependents arising out of the injury or death of a closely connected person. Looked at from a systematic point of view, this is an exception to paragraph (2)(b) of VI.-2:201 (Personal injury and consequential loss): paragraph (1) in substance states that in the cases which it addresses nothing turns on the fact that the affected persons have not in fact suffered a damage to their psychological health which “amounts to a medical condition”. Paragraph (2) in contrast relates only to those cases in which someone has been killed. The provision makes clear that (a) a legally relevant damage which the deceased suffered continues after the death to be one for which compensation is due, the entitlement to compensation passing to the heirs or representatives, (b) the reasonable costs of a funeral are a damage for which compensation is due, and (c) the survivors left behind by the deceased have a claim to reparation in respect of the maintenance foregone by them as a result of the death of their maintenance provider. Paragraph (1) concerns non-economic loss; paragraph (2)(a) relates to both economic and non-economic loss; and paragraphs (2)(b) and (c) are concerned only with economic loss.

B. Non-economic loss of close relations in cases of personal injury and death (paragraph (1))

Relation to VI.-2:201(2)(b) (Personal injury and consequential loss). As already stated, paragraph (1) provides persons who are particularly close to the injured or deceased person with a claim for compensation for their non-economic damage. This claim will exist even though the conditions of paragraph (2)(b) of VI.-2:201 (Personal injury and consequential loss) are not satisfied: Persons who are particularly close to the severely or fatally injured victim are also to be compensated for their mental suffering, even though their suffering may not amount to a medical condition.

Policy consideration. Paragraph (1) consciously exceeds the present legal position in certain European jurisdictions. It would be a value judgement which nowadays is no longer acceptable if a damage of the significance described in paragraph (1) were not to qualify as legally relevant damage. The emptiness which a person feels when a life partner, a child or a parent is killed or severely injured need not be suffered without reparation, though the parties concerned do not suffer injury to their health. Should they in fact suffer such damage, then two bases of claim are available to them. The judge must express the entire damage in terms of one sum – as a rule a lump sum (see further VI.–6:203 (Capitalisation and quantification) paragraph (1)). The rule in paragraph (1) reflects the legal position in what is by far the predominant majority of the Member States. However, this rule would be misunderstood if it were interpreted as (and criticised for) “commercialising death”. That is certainly not the case. The reason is that this rule is concerned not with enriching the relatives, but with recognising that the severest of detrimental impacts on one’s enjoyment of life is worthy of reparation.

The circle of persons affected. Included are persons who stand in a particularly close personal relationship either formally in law (spouse, children, parents) or *de facto* (cohabiting partner, step-parents). A mere friendship or a close professional or business relationship, on the other hand, is not sufficient. Such persons might exceptionally have a claim for reparation of their economic loss if the conditions of VI.–2:101 (Meaning of legally relevant damage) are met, but they do not acquire a claim to reparation of their non-economic loss.

Claim by third parties for loss of maintenance in case of death only. In contrast to the rule applicable when the injured person *dies* (cf. VI.–2:202(2)(c)), a person who was being maintained by the injured person, before the latter sustained the injury, will have no claim against the injuring person for any consequential loss of maintenance during the life of the injured person. A third party might suffer a loss of maintenance because, for example, incapacity to work has deprived the injured person of the means to earn the income out of which the injured person would otherwise have paid maintenance to the third party. However, until the death of the injured person, this expectation loss does not constitute legally relevant damage to the third party. The *injured person* will have a claim for loss of income (or consequential loss in general) under VI.–2:101 (Meaning of legally relevant damage) paragraph (4)(a), so that, even though not put in funds for some time to come, the injured person nonetheless has a legal entitlement to income out of which maintenance might be paid. That right might be either enforced or else partially disposed of in favour of the third party in lieu of maintenance. Any loss of maintenance during the life of the injured person is thus to be attributed to the decision of the injured person. This result – which emerges directly from a comparison of the various provisions on injury to body or health on the one hand and those applicable in case of death on the other – may not and cannot be circumvented by invoking the assistance of VI.–2:101 (Meaning of legally relevant damage).

C. Loss suffered as a result of another’s death (paragraph (2))

Death as such not legally relevant damage. Paragraph (2) introduces additional rules for the case where a personal injury has led to the death of the victim (whether immediately or only after the lapse of some period of time). The rules of VI.–2:201 (Personal injury and consequential loss) and potentially also VI.–2:101 (Meaning of legally relevant damage) paragraph (1)(b) and (c) remain applicable. The provision proceeds from the principle that death as such does not constitute legally relevant damage within the meaning of non-contractual liability law. The deceased has no claim which can be asserted on account of the death as such, and the loss of life as such has no value quantifiable in monetary terms which can be assigned by the system of private law to heirs or successors.

D. The claim of the deceased's successors (paragraph (2)(a))

Succession to subsisting claims of the deceased to reparation. Sub-paragraph (a) of paragraph (2) makes it clear that the deceased's successors (by which is to be understood the heirs or personal representatives, depending on what is determined by the law of succession) inherit all the rights (but only those rights) which the deceased would have been able to exercise while alive. Rights to compensation for economic damage belong in this category as much as rights to compensation for non-economic damage. Moreover, claims for compensation for non-economic damage or for anatomical damage are also generally capable of transmitting on death (a question which must be answered in the law on non-contractual liability) and that is so independently of whether the deceased while alive asserted these claims in or outside of the courts. However, had the deceased made it known that no claim would be made for compensation for non-economic damage, the deceased would in that case have waived this claim. Consequently the claim will not pass as part of the estate. The situation would be the same in a case of economic loss.

The limits of the claim. Sub-paragraph (a), however, contains a further limitation. Only those rights which the deceased had acquired during life pass to the successors. If death occurs instantaneously (without an intermediate period of suffering), then neither a claim for compensation for non-economic damage nor a claim for compensation for anatomical damage existed. The same holds for patrimonial losses.

Illustration 2

If the injured person while alive had received a complete settlement (as a lump sum) for future loss of income, this sum remains part of the inherited estate. (The situation is the same if, in the lifetime of the deceased, a lump sum settlement was reached but not paid or judgment was given.) In contrast, if the claim has been settled on the basis of monthly compensatory payments during the lifetime of the deceased, the claim will expire at the end of the month in which the deceased dies.

Illustration 3

If the deceased took to the grave some secret (such as a code word for a computer program which was only known to the deceased), the successors will receive no compensation at all. Only exceptionally will the result be different under the rule in VI.-2:101(1)(b)-(c) – in particular in the case of an intentional killing.

E. Funeral expenses (paragraph (2)(b))

Funeral costs constitute legally relevant damage. In some countries there exists a dispute of legal theory about whether funeral costs can be compensated (because they would have to be incurred anyway at some time), but the legal position today is unequivocal: funeral costs must be compensated everywhere. Sub-paragraph (b) sticks to this principle. The only problem is to determine the amount of compensation and the person entitled to claim it.

Reasonable funeral expenses. As regards the amount, the text states only that the costs must be "reasonable"; an express reference to the living standards of the deceased seemed not to be appropriate. The expression "funeral costs" is broader than the expression 'burial costs'. The former includes, for example, the costs of transporting the body from the place of death to the place of burial. The costs of caring for a grave, however, do not come within funeral costs.

Persons entitled to claim funeral expenses. Sub-paragraph (b) only states that a person is entitled to compensation if that person has paid for the costs of the funeral. A more detailed regulation is excluded for a number of reasons. One of these is the fact that the national laws

of succession are not harmonised and therefore it cannot be said for the purposes of the law on non-contractual liability who is obliged under those laws to arrange the funeral. On the other hand, of course, the person who is obliged under the law of succession or by other legal provisions to organise the burial had “reasonable funeral costs”. It is even possible, depending on the particular circumstances of a country, that a moral obligation to organise the burial may suffice. However, an insurer who takes care of the funeral “*in natura*” will not be able to claim on the basis of this Article. Ultimately it is the criterion of “reasonableness” which determines who can assert a claim to compensation for funeral costs.

F. Loss of maintenance (paragraph (2)(c))

Loss of breadwinner. Unlike the case where the injured person does not die (or has not yet died) as a result of the injury, VI.–2:202(2)(c) gives a direct claim against the injuring person to certain classes of persons who suffer a consequential loss of maintenance. As already explained in comment B, such a claim is inappropriate if the injured person has not died. Moreover, even if the injured person subsequently dies, a third party whom the injured person had previously maintained will not acquire a claim for loss of maintenance in the period between the victim’s incapacity through injury and his or her later death. The injured person’s right to reparation for loss of earnings (out of which maintenance might have been paid, if damages had been recovered) is not extinguished by death and will pass to the successors. However, the death of the injured person does create a material difference in the legal position of the injured person and alimentary creditors in respect of maintenance foregone *after death*. The deceased’s successors have no claim to the loss of income which the deceased might have earned after the time of death, had there been no injury. Consequently, there is no person entitled as against the injuring person to the income out of which maintenance might have been paid after the injured person’s death. The loss of maintenance suffered by certain classes of affected persons therefore becomes a legally relevant damage.

Persons entitled to compensation. Entitled to compensation are primarily those to whom the deceased according to legal rules (in family law) was obliged to pay maintenance. Additionally the proposed text provides for an extension of the entitlement to compensation to those who were dependent on the deceased as their *Versorger* (provider). The expression *Versorger* is easily understood in, for example, German and Swedish legal discourse. An example of a *Versorger* is the breadwinner who provides for a life partner within a stable relationship, but the term also includes, for example, a step-father in relation to a step-child within the family. The English circumlocution “provided care and financial support” is intended to express the requirement of just such a personal *Versorger* relationship.

“Statutory provisions”. These rules do not determine what is to be understood as coming within the notion of “statutory provisions”. This question must instead be decided on the basis of the applicable national law concerned. See VI.–7:102 (Statutory provisions).

Time limits. The right to reparation for lost maintenance is not of course without any kind of restriction in time. It is limited to the extent that the loss of maintenance was in fact caused by the injuring person. The relevant period of time is thus that in which the deceased would probably have maintained the surviving claimants. That period of time must be estimated, based on the probable life expectancy of the deceased had the fatal accident not occurred and, in respect of children, by considering the period during which they would have had a right to maintenance from the deceased.

VI.–2:203: Infringement of dignity, liberty and privacy

(1) Loss caused to a natural person as a result of infringement of his or her right to respect for his or her dignity, such as the rights to liberty and privacy, and the injury as such are legally relevant damage.

(2) Loss caused to a person as a result of injury to that person's reputation and the injury as such are also legally relevant damage if national law so provides.

COMMENTS

A. General

Purpose of the provision. The purpose of this provision is to clarify that loss and injury caused by the infringement of human dignity constitutes legally relevant damage which leads to an obligation to make reparation according to the basic rule on non-contractual liability. One important aspect of human dignity is the protection of a person's right to liberty; another is the protection of a person's private sphere. Of course consequential losses also constitute damage relevant to the law on non-contractual liability, whether they be economic or non-economic losses.

Horizontal effects of human rights. I.–1:102 (Interpretation and development) paragraph (2) states that these model rules “are to be read in the light of any applicable instruments guaranteeing human rights and fundamental freedoms”. The very position of this provision indicates its status as a general provision, whose significance goes far beyond the law on non-contractual liability. It is also necessary for the law of contract – for example in the law of credit securities. It seems to be certain, however, that such a general norm on the so-called ‘horizontal effects’ of human rights and fundamental freedoms cannot render a specific non-contractual liability law protection of rights of personality superfluous. Furthermore, it goes without saying that holders of rights in private law in relation to others are not subject to the same duties as the state in its dealings with citizens. Persons subject to private law who offer their goods or services to the public must, however, comply with more stringent rules than individuals conducting their private lives.

Illustration 1

For example, an infringement of dignity is made out when a business which is open to the public (e.g. a bank, restaurant or hotel) turns someone away on account of their skin colour or creed. A private person by contrast may generally adopt entirely arbitrary criteria in deciding when to let someone into his or her house.

B. Infringement of human dignity (paragraph (1))

Infringement. Technically speaking, there can be an “infringement” of the incorporeal rights of personality in VI.–2:203 within the meaning of these rules even where the injuring person can invoke a ground of defence set out in Chapter 5, e.g. VI.–5:203 (Protection of public interest). The distinction is important because the allocation of the burden of proof turns on it.

Injury and loss. The infringement of human dignity, like injury to body or health, constitutes a damage *per se*. However, a legally relevant damage is also constituted by the losses which result from that infringement. Infringements of human dignity can entail economic as well as non-economic damage.

Trivial injury. In every case the injury must not be merely trivial (VI.–6:102 (De minimis rule)). In establishing whether the case is one of trivial damage it will be material whether the injuring person has acted intentionally or merely negligently and, moreover, whether a violation of a private sphere or an infringement of freedom is at stake. For infringements of rights of personality or interferences in the private sphere which result from mere negligence there is sometimes no scope for a claim to damages. With infringements of the right to liberty, however, the position is usually different. Here negligence is often sufficient, provided that the circumstances are such that the infringement of the right to liberty equates to an infringement of human dignity. Everything depends on assessing the circumstances of the individual case. The regulation of the corresponding details must therefore be left to the courts. Furthermore, the generally applicable principle of Chapter 6 that reparation is to be awarded in a way which best corresponds to the injury suffered (VI.–6:101(2) (Aim and forms of reparation)), which necessarily involves a consideration of commensurability between the award and the damage, may have particular significance here. Compensation, for example, will not be due where the infringement of a right to respect for personal dignity is trivial.

Illustration 2

A sensationalist news gatherer forces a way into a hotel room in order to catch a famous person “in flagranti”. Protection against such conduct obviously calls for liability to make monetary reparation. Where, however, a hotel guest enters the wrong room by mistake, that is not normally such a serious infringement of the private life of the other guest concerned as to give rise to a claim to compensation. However, the hotel guest is of course obliged to leave the room immediately (i.e., there is a right against further intrusion) and in the event of a stubborn refusal to do that, the invasion of the private sphere ceases to be trivial.

Groups of cases. Furthermore, there exists today a whole spectrum of relatively firmly settled groups of cases in which the laws on non-contractual liability affirm an infringement of human dignity or, as is often said, an infringement of personality. Particular mention may be made of degrading and marginalising the social profile of a person, cases of unlawful exposure to publicity and infringements of family-related rights of personality. However, these groups of cases are not particularly stressed in the text of the provision in order not to hinder further developments and its application to specific cases. An example of unlawful exposure to publicity is to be found in the following illustration:

Illustration 3

While in hospital recovering from severe head surgery, a famous actor is illicitly tracked down to his hospital room, and interviewed and photographed there by sensationalist journalists. This occurs while he is neither capable of answering questions rationally, nor even consenting to the “interview”. This amounts to a case of an infringement of his right to the protection of his personal dignity.

Sexual harassment; Community law; II.–2:101 (Right not to be discriminated against).

An infringement of human dignity is of course also made out in a case of sexual harassment. European Community law defines “harassment” in Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods (OJ L 373/37 of 21 December 2004) art. 2(c) as “an unwanted conduct related to the sex of a person ... with the purpose or effect of violating the dignity of a person and of creating an intimidating, hostile, degrading, humiliating or offensive environment”. Art. 8(2) loc. cit. provides: “Member States shall introduce into their national legal systems such measures as are necessary to ensure real and effective compensation or reparation ... for the loss and damage sustained by a person injured as a

result of discrimination within the meaning of this Directive, in a way which is dissuasive and proportionate to the damage suffered. The fixing of a prior upper limit shall not restrict such compensation or reparation.” VI.–2:203 does not provide merely for protection against sexual harassment. The rule also guarantees that in cases regulated by II.–2:101 (Right not to be discriminated against) an appropriate remedy under the law on non-contractual liability is available: see II.–2:104 (Remedies).

Protection of minors. Minors require special protection from sexual assault.

Illustration 4

Father F coerces his underage daughter to have sexual intercourse with the threat of killing himself otherwise. This constitutes a violation of the child’s personality; and in addition, depending on the other circumstances of the case, also an infringement of the mother and wife’s right of personality.

Illustration 5

An infringement of a person’s sexual sphere through omission is also conceivable, e.g. where the administration of a home for mentally disabled minors fails to prevent young girls from engaging in sexual intercourse for which they are not emotionally and socially prepared. To deal with the specific problem area of electronic media, a Council Recommendation on the protection of minors and human dignity in audiovisual and information services has been in place since 24 September 1998, and has been expeditiously incorporated in a number of national legal systems (Evaluation Report COM (2001) 106 final).

The right to liberty. VI.–2:203 does not attempt to enumerate all manifestations of the infringement of another’s dignity that are relevant to the law on non-contractual liability. In light of the multifaceted nature of life, this would be impossible. However, particular mention is given to the invasion of a person’s private or indeed intimate sphere, and the infringement of another person’s liberty. By ‘liberty’ the text comprehends freedom of physical movement, i.e. the right to leave the place in which one currently finds oneself and the right not to be compelled to go to a specified place. On the other hand there is no infringement of liberty in being prevented from entering a given space or in being merely adversely affected in the freedom to resolve upon some action.

Illustration 6

Without good reason an association prohibits one of its members access to the club rooms. There is no infringement of liberty to the detriment of the member of the association.

Illustration 7

The position is the same if somebody parks a car so as to block another parked vehicle and prevent its owner, returning from a shopping trip, from driving away. This case may well be relevant from the viewpoint of the violation of a property right. It does not involve an infringement of liberty, however, for the simple reason that the driver of the car can leave the parking space at any time by other means.

Illustration 8

On the other hand, liberty is infringed if someone is locked in a room – even if the occupant is lying inside with a broken leg and could not possibly have ventured from the spot. Critical is the fact that the right is infringed and not whether the right could actually have been utilised.

Arrest and imprisonment of innocent persons. The problem of the state’s liability in cases where innocent persons are arrested and imprisoned remains outside the scope of application of VI.–2:203. This follows from VI.–7:103 (Public law functions and court proceedings).

The right to privacy. The Article also gives express mention to the right to protection of the private sphere which is conceived as a manifestation of the right to protection of personal dignity. The right to protection of the private sphere assures every person an untouchable personal living space which everyone must respect. The ways in which the private sphere may be violated are for their part so numerous that they elude capture within an exhaustive group of cases. They include, for example, harassment and, more remotely, deliberately spying on others in their personal life. On the other hand, there is no violation of the private sphere when a photograph is taken of a private estate, albeit without permission. Such conduct may, however, amount to a violation of a property right or a violation of a legally protected interest.

Persons of contemporary celebrity. It must be stressed that the right to a private sphere is enjoyed by everyone and therefore also by celebrities. “Private sphere” must be understood not merely spatially, in the sense of a private dwelling (flat, house, etc). Rather it also subsists where, for example, someone wishes to eat in a restaurant alone or with friends and the existence there of a private sphere is quite independent of whether the person is or is not of current notoriety.

Illustration 9

The right to a private sphere is thus infringed by someone who covertly photographs a world famous princess during her stay in a fitness studio with a hidden camera and without her knowledge while she is exercising in a separate room, or by someone who photographs her in a café in which she is chatting with friends in private company.

Protecting a public interest. The defence of protection of the public interest (see VI.–5:203 (Protection of public interest)) is not fundamentally set against infringements of human dignity because the protection of human dignity is itself (also) in the public interest. However, that does not remove the need to consider all the circumstances of the individual case when determining whether there is in fact an infringement of dignity. The defence of acting in the public interest can also assume significance in the context of VI.–2:204 (Loss upon communication of incorrect information about another) where defamation takes the form of disseminating false information about another person to that person’s prejudice.

C. Legal persons

Application of the general rule on legally relevant damage. The text specifically addresses only the infringements of incorporeal ‘personality rights’ (*Persönlichkeitsrechte*) of *natural* persons. The particular problem whether legal persons too are endowed with a “right of dignity” is not expressly addressed in the provision. The matter therefore falls to be resolved by judicial consideration under VI.–2:101 (Meaning of legally relevant damage) paragraph (1)(b). See comments on VI.–1:103 (Scope of application). Depending on the current rules on fundamental rights in a given country, it is conceivable that this issue will result in diverse solutions. On the other hand, there is no doubt that legal persons can commit a violation of a right of personality. In other words, within the framework of VI.–2:203, they do not come into consideration as claimants and injured persons, but they certainly do as opponents of claims and injuring persons. That holds true also for businesses in the media. Such undertakings enjoy no constitutional protection of their existence in the sense that they cannot be called on to make reparation, even though the quantum of the claim may be such as to endanger the financial basis of the undertaking.

D. Posthumous protection of personality rights

Post-mortem protection of personality and protection of one’s own rights. As already mentioned, the problem of posthumous protection of personality rights is likewise not expressly regulated. Here too substantial reference is made to the relevant national conception

of fundamental rights. The courts consequently must resolve the questions relating to posthumous protection of personality rights on the basis of VI.-2:101(1)(b). Often the matter will only revolve around claims to a prohibitory order made by near relatives who are contesting a particular account of the deceased's life. A claim to damages in such cases would only rarely come under consideration, but it is not excluded if it concerns an economic loss – for example, where unfair use is made of the deceased's name or image for advertising purposes. However, it will not infrequently be the case that the relatives themselves can proceed on the basis of an infringement of their own rights because they are affected in their own dignity. Where a posthumous right of personality is accepted, it is also beyond question that such a right cannot be protected in perpetuity. A solution which commends itself, by analogy to the EU Directive 93/98/EEC harmonising the term of protection of copyright art. 1(1), is to adopt at the uppermost a maximum period of 70 years from death.

E. Defamation (paragraph (2))

Defamation not specifically addressed in the Chapter 2, Section 2. Section 2 of Chapter 2 does not contain any specific provisions on defamation. That is because it appears to be extraordinarily difficult to formulate in a way which is politically acceptable some regulation in non-contractual liability law of the complex issue of protection of 'honour'. The extent to which honour, reputation, good standing or status in society, or similar attributes of a person should be protected by the legal system is a matter of controversy among the various European jurisdictions, not least because of the correlative limitation of freedom of expression which such protection necessarily entails. Consequently, no attempt has been made directly to protect such attributes of the person in any general way. The text confines itself to providing that an injury to reputation is a legally relevant damage if this is envisaged by the applicable national law. However, where national law does not impose liability, a claim may nonetheless succeed if it involves communication of false information for which the responsible person is accountable: see VI.-2:204 (Loss upon communication of incorrect information about another).

Criminal defamation. It has also emerged as impossible to base the rule on the minimum proposition that a legally relevant damage is at least present if the claimant is made the victim of a criminal defamation. That approach would have led to diverse legal results (since the criminal laws are not coordinated). For example, a defamatory statement which is communicated only to the individual defamed constitutes a criminal defamation in some criminal jurisdictions only (e.g. in Germany, England and Wales, but not in Austria and in Spain). Admittedly, such variations in the applicable criminal law would not have been a peculiarity of this area. The same inherent diversity is also true, for example, of liability for breach of statutory obligation (because such obligations differ from place to place) and even for liability for negligence because the way in which this concept is made concrete is and will remain dependent on local particularities. Nonetheless the problem of diversity is particularly acute here. There are some national legal systems (e.g. the Common Law ones) for which certain criminal defamations do not give rise to liability in private law. This problem of a criminal law which runs into overkill for private law purposes would necessitate an express limitation. For the purposes of liability in private law only those crimes could be regarded which serve to protect the honour and good reputation of the individual; one would have to disregard those crimes which seek to protect the public interest (e.g. preventing a disturbance of the peace or an affray) and where the making of a defamatory statement which is *true* is therefore criminalised. The necessity for such a limitation, however, would serve only to show that the fundamental question of when an individual should be entitled to redress for defamation would not be solved by appeal to the criminal law. For while the existence of a crime shows, by definition, that *in relation to society* a person has overstepped the bounds of

freedom of expression, this does not automatically resolve the further question whether *in relation to the claimant* that act warrants a right to redress in private law. Conversely there are also cases in which a private law liability is affirmed but the criminal law takes no cognisance of a crime. That is again particularly problematic for English law, where libel but not slander may constitute a crime and where the arguably required element of seriousness for punishment by the state excludes many non-trivial cases where non-contractual liability is recognised. The position is even starker in Scotland, which no longer recognises a criminal act of defamation. In that regard, as regards Scottish law, a provision on non-contractual liability for criminal defamation would have achieved nothing. It is in the light of such difficulties and complexities that the attempt to couple non-contractual liability for defamation at a European level with infraction of national criminal law was abandoned.

Freedom of expression. Obviously all European societies respect and nurture a domain for freedom of expression, quite irrespective of considerations of public interest protecting the making of statements which would otherwise be regarded as having overstepped the bounds of that freedom. However, in given circumstances, an attack on a person's status in society may be so wanton or so severe in its means or depth, for example, that it can properly be said to have infringed a person's right to respect for personal dignity. There may be no right to any particular level of standing in society (since society will make its own mind up about the merits of one's character and achievements); but an individual's right to respect for personal dignity includes the right not to have to tolerate a vicious and unjustified rubbishing of reputation.

F. Relation to other provisions in chapter 2, section 2

Overlaps. It is conceivable that the scope of application of VI.-2:203 overlaps in several cases with the scope of application of other provisions, but that does not represent a problem. The injured person in such a case would have two or even more grounds of action but naturally only one claim to compensation or other remedy. However, it may well be that in a single event a cumulative set of wrongs emerges which, in ascertaining and making good the damage done, are to be treated separately. An example would be where personal injury to a foreigner is caused by right-wing thugs simply on account of the victim's different appearance.

VI.-2:204: Loss upon communication of incorrect information about another

Loss caused to a person as a result of the communication of information about that person which the person communicating the information knows or could reasonably be expected to know is incorrect is legally relevant damage.

COMMENTS

A. General

Liability for misinformation instead of protection of honour. This Article is based on the notion that one can hardly dispute liability for misinformation, whereas liability for "injury to honour" can easily open up a source of endless disputes and the exertion of influence by lobbyists (e.g. through the press). The concepts of honour or reputation therefore only play a role within the scheme of these rules to the extent that they are also applicable as part of national law: see VI.-2:203(2) (Infringement of dignity, liberty and privacy) and the

comments on that Article. Moreover, in an open society a rule which simply characterised injury to reputation as a legally relevant damage would be too imprecise. The assertion that someone belongs to a political party or has subscribed to a particular school of thought is anything other than an imputation of dishonour. At the same time such assertions, if they are false, may inflict substantial damage on that person's progress in life. The same applies to the assertion that a given Catholic priest supports abortion. It would also be less productive to have to resolve the question whether an athlete's honour is injured when it is falsely asserted that he or she takes drugs. All of these cases turn only on the point that the information was false.

Protection of the media. From the perspective of the media too it can hardly be maintained that there is a fundamental problem with press freedom when the published information is false. False assertions are as a matter of general principle not within the protection of press freedom. Incorrect assertions which cast the person concerned in a more favourable light than they are really entitled to, however, will as a rule not result in damage.

Personal honour need not be affected. It follows from the approach chosen here that the incorrect information need not affect the injured person's personal honour at all. It suffices, for instance, that the incorrect information causes doubt about the injured person's credit-worthiness. If, however, the false information also adversely affects the injured person in the pursuit of a profession or trade, as is likely to be the case e.g. if information is addressed to customers or suppliers, the requirements of VI.-2:208 (Loss upon unlawful impairment of business) may also be satisfied.

Persons. The text makes no distinction between natural and legal persons. A "person" within the meaning of this provision includes (according to the general rule, see VI.-1:103(b) (Scope of application)) legal as well as natural persons. Deliberately omitted from this provision, however, is the protection of personality after death: see comments under VI.-2:101 (Meaning of legally relevant damage) and VI.-2:203 (Infringement of dignity, liberty and privacy).

Defences. The general grounds of defence in Chapter 5 have application in relation to VI.-2:204 as they do in relation to other instances of legally relevant damage. However, VI.-5:203 (Protection of public interest) takes on a special significance here. Furthermore, regard must also be had to VI.-6:102 (De minimis rule) – in particular in relation to the legal relevance of non-economic losses. (See the comments on those Articles.) Moreover, liability in consequence of VI.-2:204 (or indeed any other Article under this Chapter) will be excluded where it would conflict with constitutional rights, such as rights of freedom of expression, which are enshrined in the national laws: see VI.-7:101 (National constitutional laws). National constitutional law may, for example, come into play to protect the fundamental right to marriage and family life with the consequence that confidential information communicated between spouses can never give rise to liability and in particular therefore when information about a third party which is known to be false is communicated by one spouse to the other.

B. Communication

Communication and dissemination distinguished. The element of communication of the information does not require a "dissemination" in the sense of either communication to a determinate or indeterminate group of persons or a chain or repetition of communications to a number of persons (multiple simultaneous or serial communications). A "one to one"

communication can fall within the Article and likewise a communication on a single occasion suffices. It is not essential that communication should take the form of a wide publication of information directed to the public at large. Depending on the circumstances, it may suffice that the information has been passed down the telephone line to a single individual. VI.–2:204 is therefore in no way confined to the dissemination of false news in the media. It may also apply to false information communicated among business persons or even private contacts (who turn, for example, to the press, or the employer or school of the individual concerned) where, however, according to the general rules on accountability, different standards of care are imposed.

Internet communication. The position is the same where false information about another is incorporated into a web page on the internet. As regards publications in the internet, it will always be necessary to ascertain precisely who is the person who “ought to know” that the information is incorrect. As far as intermediary service providers are concerned, this issue is specifically addressed and conclusively resolved by Directive 2000/31/EC of the European Parliament and the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce') (OJ L 178 of 17 July 2000, p. 1-16), section 4 (“Liability of intermediary service providers”), arts. 12-15.

Repetition of incorrect information. The person communicating the misinformation need not be the person who has created or formulated it. The repetition of incorrect information which has been obtained from another will amount to a communication; there is no requirement of ‘first dissemination’ in VI.–2:204. In the context of transmission of false information in this manner, however, note must be taken of the element of accountability. If publishers have repeated in good faith information obtained from a source in whom it would be reasonable to place reliance (such as communications from public authorities within their sphere of activities) and where it would be unreasonable to expect the publishers to examine the matter in any depth for themselves without repeating it (because, on its face, it has an innocent character), there may be no legally relevant damage.

Telling lies. On the other hand, VI.–2:204 does not mean that a person is liable *per se* for having told a lie. Making a misstatement, even intentionally, does not by itself give rise to liability. Only when additional elements besides the mere falsehood of the information are present does a right to relief arise under this Article. The misstatement must be “about another” and it must result in either a disturbance to that person’s life or economic loss. Trivial damage is not legally relevant (VI.–6:102 (De minimis rule)). It is the consequences - the prejudice caused to another *in consequence of the misstatement* - which generates the claim under this Article and not the mere fact of the misstatement.

C. Incorrect information

Facts and value judgements distinguished. Information within the meaning of VI.–2:204 is an assertion of fact and does not extend to mere expressions of opinion or value judgements. The borderline between these two basic categories is not always easy to draw, but it is conceptually clear because only assertions of fact are susceptible to proof of veracity. Information is incorrect when it does not correspond with the truth. Information which is hearsay must be disclosed as such in order to correspond with the truth: someone who in that manner communicates information, making it clear that it is not known whether the reported assertion is correct, does not generally communicate false information unless this caveat serves only as a blind to escape liability (e.g. because it is sham and the information is relayed

not merely to report that another has made such an assertion, but rather to imply also that the assertion is correct). The same applies when the information communicated contains the pointer that the assertion is made on the basis of only limited investigation.

Illustration 1

In the course of divorce proceedings, in order to further his position, a husband asserts that his wife “cheated” on him with another man. This is an assertion of fact.

Illustration 2

A theatre critic writes of a singer and actress that her voice and acting are so bad that she belongs not on the stage, but at the cash register in a self service restaurant. This is a value judgement.

Information about a person. VI.–2:204 concerns false information about a “person”; it does not extend to false information about a product or service.

Illustration 3

The assertion that electronic organs are completely unsuitable for use in churches falls outside VI.–2:204 and consequently does not provide the manufacturer of such organs with a claim to reparation of legally relevant damage under this rule, even where the statement was reinforced by concrete (but false) assertions of fact: it does not pertain to information about the manufacturer’s person.

Burden of proof. The provision refers to information which is “incorrect”. Starting from the proposition that the claimant must make out all the elements necessary to support the cause of action, this Article has the effect of placing on the claimant the burden of proving that the information communicated was “incorrect”. However, in contrast to burden of proof (which is a material aspect of the rule), the standard of proof required will remain a procedural matter not governed by these rules. The same holds true for the question whether any alteration in the rules governing the standard of proof are considered appropriate so as indirectly to ease the onus placed on the injured person.

D. The mental state of the responsible person

Carelessness in relation to the incorrectness. As regards the mental state of the injuring person, negligence is always sufficient. That is so as much in relation to the act of communication or publication (which is governed by VI.–3:102 (Negligence)) as in regard to the fact that the injuring person ought to have known that the information was incorrect (which is governed by this Article). The Article therefore provides for liability when, for want of reasonable thoroughness or accuracy in research, the injuring person has communicated the false information. This will entitle the claimant to any appropriate remedy, including compensation. Conversely, where false information is published without negligence, because the information was communicated with every good reason (in the light of scrupulous research) to suppose that it was correct, there will be no liability, notwithstanding that the publication of false information may make a detrimental impact.

E. Relationship to other provisions

VI.–2:203 (Infringement of dignity, liberty and privacy). However, the fact that there is no liability under VI.–2:204 (and therefore no right to a correction of the falsehood as reparation for damage under this Article either) does not mean that the party innocently injured is entirely without redress. Precisely because the publisher has injured another by

actions (albeit without liability), the publisher may in given circumstances be under an obligation to publish a correction in order to eradicate or ameliorate the prejudice or detriment generated. Such a positive obligation to rectify may arise out of the duty not to infringe an individual's right to respect for dignity implied by VI.-2:203 (Infringement of dignity, liberty and privacy). A failure to respond to the plea of an affected individual, whom one has significantly maligned or prejudiced by one's own (innocent) act, to salvage that individual's reputation may amount in some cases to such a failure to treat the other person with the minimum respect which a fellow member of society merits as to infringe the right to personal dignity. This specific damage falling under VI.-2:203 makes it unnecessary to fall back on the wider argument to the same effect under the general residual rule on damage in VI.-2:101 (Meaning of legally relevant damage), at any rate where the person adversely affected is a natural person.

Reporting suspicions. VI.-2:203 (Infringement of dignity, liberty and privacy) may be of particular relevance in relation to the reporting of suspicions. Where a report is made that someone is suspected of wrongdoing or circumstances are detailed which pinpoint a given individual as a plausible suspect for the wrongdoing, there will as a rule be no scope for liability under VI.-2:204. That is for the simple reason that the reported information is correct so far as it goes (i.e. there *is* a suspicion, there is no good reason to assume that the suspicion is wrong or ill-founded, and the circumstances *are* as narrated).

Illustration 4

A newspaper reports about a letter in which A informs B that he (A) suspects a third party (C) of being guilty of electoral malpractice and having committed a criminal offence which should be reported to the police. Since the newspaper correctly reproduced the contents of the letter, without passing the contents off as its own, and since there was a public interest in the publication of the news, the report does not cause legally relevant damage in the sense of VI.-2:203 (Infringement of dignity, liberty and privacy) or VI.-2:204 (Loss upon communication of incorrect information about another), even if C is later acquitted of the charge.

Freedom of expression and the right to respect of dignity. However, depending on the precise circumstances of the case, it is conceivable that reporting of the suspicion itself in this way, while communicating correct information, could nonetheless be subject to the competing right of the individual to respect for personal dignity. This must necessarily be the case because reporting (truthfully) a suspicion so as to expose a given individual to the negative attention of others may in some contexts amount to placing an individual on trial in a forum in which there is no means of defence against the more or less explicit accusation. This may easily overstep the bounds of fair treatment of the individual and thus amount to a denial of the right to respect for personal dignity. No definite guidance can be given here, since the matter will be one for the courts to elaborate in the context of the inescapable conflict of interests between freedom of expression and a right to be treated with dignity. However, even where reporting a suspicion does infringe a person's right to respect for personal dignity, this will be subject to the defence of public interest, that is to say a justifiable ground for publishing the suspicion (see further VI.-5:203 (Protection of public interest)). This will clearly be the case, for example, where a newspaper acts responsibly in publishing descriptions or images of persons wanted for questioning in respect of serious crimes. Quite aside from that defence, it may well be that an infringement is not so profound as to justify compensation, as opposed to some other remedy which serves directly to remove the stigma or prejudice which reporting the suspicion generated (such as a right to have published further

details which will make manifest the individual's innocence). In every case the remedy must be appropriate to the injury caused: see VI.-6:101(2) (Aim and forms of reparation).

VI.-2:205 (Loss upon breach of confidence) and VI.-2:207 (Loss upon reliance on incorrect advice or information). Liability arising under VI.-2:204 in respect of communication of information to another's prejudice is further flanked by the rules in VI.-2:205 (Loss upon breach of confidence) (where there is a breach of confidence) and VI.-2:207 (Loss upon reliance on incorrect advice or information) (where false information is communicated in the course of business to one who relies on it).

VI.-2:208 (Loss upon unlawful impairment of business). In a few cases there may be an overlap with the scope of application of VI.-2:208 (Loss upon unlawful impairment of business) – for instance where false information about a competitor is “spread” to customers in order to ruin the competitor.

VI.-2:205: Loss upon breach of confidence

Loss caused to a person as a result of the communication of information which, either from its nature or the circumstances in which it was obtained, the person communicating the information knows or could reasonably be expected to know is confidential to the person suffering the loss is legally relevant damage.

COMMENTS

A. General

Source of inspiration. The provision takes its inspiration from the rules on liability for breach of confidence originating in the Common Law. Loss suffered as a result of a breach of confidence amounts to damage recognised in the law on non-contractual liability. Liability, however, only arises if all the other requirements of VI.-1:101 (Basic rule) (i.e. causation and accountability) are satisfied as well.

Relationship to other rules. In a few situations, the damage described in this Article may coincide with injuries or losses that already amount to legally relevant damage under other provisions. According to the general rules, the claimant then has multiple causes of action, but of course can only have the total damage satisfied once. Since VI.-2:204 (Loss upon communication of incorrect information about another) relates to false information while the present Article, in contrast, deals with correct (but confidential) information, each rule's scope of application is clearly separate from the other. It is readily conceivable, however, that a breach of confidence may cause e.g. damage to mental health in the sense of VI.-2:201 (Personal injury and consequential loss) – for instance, where a doctor breaches doctor/patient confidentiality and consequently an already psychologically fragile patient becomes severely depressed. Moreover, cases of absolute confidentiality may fall to be addressed under the right to privacy whose infringement constitutes a breach of the right to respect for personal dignity (VI.-2:203 (Infringement of personal dignity, liberty and privacy)). Nonetheless, despite such overlaps, it cannot be assumed that VI.-2:205 is superfluous. In the first place, VI.-2:203 is confined to protecting a natural person's right to personal dignity, whereas VI.-2:205 also provides protection for the confidences of legal persons. And secondly, the confidential information may not be of a ‘private’, that is to say, personal nature: an

individual's sensitive commercial information would fall for protection primarily under this Article, rather than as an aspect of privacy.

II.–3:302 (Breach of confidentiality). II.–3:302 (Breach of confidentiality) governs a special case of so-called culpa in contrahendo. The Article imposes on a party who has obtained confidential information from a contractual partner in the course of the contractual negotiations a duty neither to disclose that information nor to use it for the party's own ends. Provision is made for compensation for damage suffered and restitution of the benefit received where this duty is breached. Thus VI.–2:205 and II.–3:302 (Breach of confidentiality) in part cover like situations. Their relationship to one another is determined by the general rules for cases of conflicting regulations set out in VI.–1:103 (Scope of application) sub-paragraphs (c) and (d). Due to VI.–6:101 (Aim and forms of reparation) paragraph (4) it is conceivable that liability under II.–3:302 (Breach of confidentiality) extends further than liability under general non-contractual liability law. In this case, according to VI.–1:103(d), contractual liability for the committed culpa in contrahendo prevails. Conversely, VI.–2:205 is the basis for a claim where the parties neither concluded a contract nor even engaged in any contractual negotiations.

Illustration 1

A informs B about A's idea for a new carpet grip with express reference to the confidentiality of this information. Without the conscious intention of plagiarism, B further develops this idea and exploits it for commercial ends. B is liable to A in damages even where B and A were not in contractual negotiations.

Relation to Chapter 3, Section 1. The subject matter of VI.–2:205 are all those circumstances establishing an obligation to respect the confidentiality of information. This extends beyond cases of actual knowledge of confidentiality to cases in which there is an absence of knowledge only because the injuring person has been careless in appreciating the circumstances. All questions relating to the mode of breach of duty, however, are the subject matter of Chapter 3, Section 1. The breach of duty consists in the communication of the confidential information. To be capable of establishing liability the communication must either be intentional or negligent within the meanings of VI.–3:101 (Intention) or VI.–3:102 (Negligence).

B. Communication of confidential information

Communication. The provision, like VI.–2:204 (Loss upon communication of incorrect information about another) which invokes the same concept of "communication" of information, presupposes a communication of the information to a third party. What types of act constitute such a "communication" must be established on a case by case basis in harmony with the development of that concept within the parameters of the preceding Article. It is not a ground of defence that the information is true, but furtherance of a public interest (see VI.–5:203 (Protection of public interest)) may play a role here too as a ground of defence.

Information. The expression "information" in the context of VI.–2:205 has the same meaning as in the context of VI.–2:204. It embraces assertions of fact, not mere value judgements. The subject-matter of VI.–2:205, however, consists of true assertions of fact (since only true assertions of fact can be confidential), and, in contrast to VI.–2:204, it need not necessarily relate to information about the injured person. It may concern information about third parties or other circumstances e.g. a commercial transaction or a business concept (as in illustration 1).

Third parties. Liability arising on the basis of VI.-2:205 only affects those who communicate the confidential information. Third parties who exploit for their own purposes a breach of confidence by those to whom the information was entrusted do not come within this provision. Conceivably, however, such persons may be liable under the rules of unjustified enrichment in respect of the benefits derived from making use of this protected ‘asset’ of the victim.

Absolute and relative confidentiality. The provision embraces not merely cases in which the recipient of the information has obtained the information when sworn to silence, but also cases in which the information is relayed when the recipient knew or ought to have known that the information was confidential and not for further communication. The injuring person need not positively have known that confidential information was involved; it is enough that the confidentiality of the information ought to have been recognised and that the information is communicated merely negligently. Thus the confidentiality protected may be either ‘relative’ or ‘absolute’ in character. The former is concerned with information which is made confidential only by the manner in which it is transmitted (typically, where it is made explicit that the information is to be treated as a matter of confidence). This certainly addresses cases in which information is directly imparted by the person affected in explicit terms of secrecy, but it also extends to cases where the information is received directly, provided the recipient ought to know from the manner of communication that the information is confidential to someone other than the intermediary (e.g. because the intermediary has repeated the explicit requirement of secrecy) or has ‘eavesdropped’ on the original communication and in that way learned that the recipient must treat the information as confidential. The latter is concerned with cases where the information has in some other manner become available to the injuring person and it is the very obvious sensitive nature of the information itself, rather than the manner in which it is come by, which signals or ought to signal the confidential character of the information. Classic examples would be the discovery of another’s medical records or private journal.

Illustration 2

An employee of a health authority passes on information to a reporter, which, if published, would be sufficient to identify two doctors as suffering from AIDS. The doctors can claim an order (under VI.-1:102 (Prevention)) to restrain publication.

C. Legal consequences

Reparation and prevention. As long as the other prerequisites of VI.-1:101 (Basic rule) are present, in particular causation and intention (or negligence), the usual legal consequences arise. Thus reparation may be demanded for both non-economic and economic losses (VI.-2:101 (Meaning of legally relevant damage) paragraph (1)). In cases involving VI.-2:205, preventative legal protection (VI.-1:102 (Prevention) and Chapter 6 Section 3 below) as well as the rule in VI.-6:101 (Aim and forms of reparation) paragraph (4) assume particular significance. The latter provision allows damages to be assessed according to the amount of profit realised by the injuring person .

VI.-2:206: Loss upon infringement of property or lawful possession

(1) Loss caused to a person as a result of an infringement of that person’s property right or lawful possession of a movable or immovable thing is legally relevant damage.

(2) *In this Article:*

(a) *loss includes being deprived of the use of property;*

(b) *infringement of a property right includes destruction of or physical damage to the subject-matter of the right (property damage), disposition of the right, interference with its use and other disturbance of the exercise of the right.*

COMMENTS

A. General

The Article in overview. This Article takes as its subject-matter loss caused by an infringement of another's property right or lawful possession (paragraph (1)). Paragraph (2) explains what is meant by "loss" and "infringement" of property. The definition of "loss" in VI.-2:101 (Meaning of legally relevant damage) remains unaffected by this; VI.-2:206(2)(a) is concerned with extending, not restricting, that general definition.

Accountability. Under these rules, the infringement of a property right and infliction of legally relevant damage thereby occasioned do not automatically result in liability. As with all the Articles in Chapter 2, VI.-2:206 pertains only to the question of what constitutes legally relevant damage. Whether someone is then liable for it, is only decided in the Chapters that follow: the injuring person must have caused the damage deliberately or negligently or be otherwise responsible for its causation and have no defences available.

Loss as legally relevant damage. VI.-2:206(1) makes it clear that an infringement of a property right is not damage *per se* (injury as such). Rather the existence of a legally relevant damage depends on the existence of an economic or a non-economic loss.

Illustration 1

N has cultivated land belonging to L without L's permission or other authority. The pleasant decorative effect as well as the investment of plants has added considerably to the value of the land. Since N has made use of L's land and modified its appearance, N has infringed L's property rights in respect of the land and L may have a right to prevent further acts of gardening, infringing his property rights, under VI.-1:102 (Prevention), but N's interference has not necessarily caused L any legally relevant damage. Indeed, so far from causing L an economic loss, N's activity has conferred on L a valuable benefit if L is not correspondingly liable to N (under the law of unjustified enrichments) for the full value of the improvement to the land. Unless L can show that the use of the land has interfered with his (L's) plans (e.g. because L will now incur a cost in having to clear the land of trees and shrubs to make way for a building) or that he has suffered some other loss as a result of the infringement of his property rights, L will have suffered no legally relevant damage.

Illustration 2

A ship damages a disused and worthless quay. Damage to property, in the sense of a violation of ownership rights, it may be, but legally relevant damage it is not. The latter would require a financial loss on the part of the quay owner.

Relationship to other regimes. Consideration must also be given to the fact that in relation to title to things some special statutory regime may apply and will then take precedence over VI.-2:206 (see VI.-1:103(c) (Scope of application)) as far as its purposes so require. That will

be of significance in particular in relation to infringements of property rights within a so-called owner-possessor relationship.

Remedies. VI.–2:206 must be read in conjunction with the provisions on remedies contained in Chapter 6. Particularly of note in this context are VI.–6:101 (Aim and forms of reparation) paragraph (3), VI.–6:104 (Multiple injured parties) and VI.–6:201 (Injured person’s right of election). VI.–6:101(3) concerns cases in which the costs for the repair of a thing exceed their value. VI.–6:104 in its main thrust addresses the question who among several holders of property rights in relation to a given thing can demand reimbursement of expenditure on repairs. Finally, it falls within the framework of VI.–6:201 (Injured person’s right of election) to consider whether it is one or the other holder of a property right or only both of them together who is or are authorised to decide whether the compensation provided is to be invested in reinstating the property to its former condition or whether it should be applied for other purposes.

B. Property rights and questions arising from property law

Terminological difficulties. Hitherto, the private law systems of the European Union neither boast a unified concept of “ownership” nor a uniform notion of “lawful possession”. Thus, it may be that in the course of further deliberations on a European private law it will prove necessary to adjust the formulation of VI.–2:206 in line with more recent developments. On the other hand, it appeared to be untenable not to expressly rank losses resulting from an infringement of ownership or lawful possession under the “Particular Instances of Legally Relevant Damage” solely because of apparent terminological and conceptual difficulties that are still tied to both those notions. The law of property’s inconsistent terminology does not call into question the general core content of the values underlying non-contractual liability law.

Property rights. VI.–2:206 expressly relates only to property rights in movable or immovable things. However, this provision is not limited to any specific type of property right. Generally any proprietary right will suffice. It is not necessary that the claimant affected be the owner of all interest in the property. “Infringement of property” within the meaning of the provision may also be suffered by one who is admittedly not the holder of all the rights of an owner in the property, but who holds some of the property rights which make up ownership (e.g. a mere pledge). What rights are in point of fact “property rights” can only be answered, at the current stage of European legal development, by dipping into the respective applicable national law. An example is provided by the question of whether one who has acquired subject to the seller’s reservation of title is to be regarded as a holder of a property right (i.e. of a so-called *Anwartschaftsrecht*). The answers to this question may turn out differently, without thereby putting in doubt the principle that VI.–2:206 seeks to express.

Nuisance. In order to ascertain whether there is damage under VI.–2:206, which turns on the infringement of a property right, it will be necessary to look to property law to ascertain the boundaries of any right: the act of the injuring person must be an incursion on another’s rights of property. As has already been noted, this interrelation between the law in this Book and the law of property (on which European rules remain to be developed) will be of particular significance in relation to nuisance. While the cause of action arises in this Book by virtue of damage suffered within the meaning of VI.–2:206, to establish that the injuring person’s conduct infringed the injured person’s rights as landowner will depend on showing that the injuring person exceeded the bounds of enjoyment determined in property law for the use of the land. What levels of noise from neighbours, for example, must be tolerated by a

landowner, and what can be objected to, will be part and parcel of the demarcation of the limits of property rights as between neighbours. Such intangible boundaries are as much a part of property law as the physical divide between different land holdings. A similar point may be made in relation to rights of property in movables. Those rights may be limited by social *mores* and accepted conventions, so that in given circumstances, quite aside from questions of whether the injury is so trivial as to preclude the grant of redress, it may be that as a matter of property law there is no infringement of a property right and therefore no damage under this Article. Questions of this sort must also be resolved on the basis of national property law.

The owner-possessor relationship. However, this does not exhaust the property law dimension. In particular, it is important to recognise that VI.–2:206 may be ousted by special rules in the various jurisdictions (until now often collated in a self-contained part of a civil code) governing the so-called owner-possessor relationship. There are two difficulties here arising from the fact that many (but by no means all) jurisdictions allow the claim of acquisition in good faith from transferors to succeed where the acquirer obtains title being ‘merely’ (as opposed to grossly) negligent as to the seller’s title. Thus, for example, a purchaser of a car from a person who presents a log book with a falsified entry may acquire good title from the unauthorised transferor, even though the falsification could have been ascertained if the log book had been scrutinised with more care. The first implication of this proposition of property law is that the transferee can acquire property in circumstances of bare negligence. That means that if, without more, the non-contractual liability law provisions on infringement of property rights were applicable, it could be supposed that the transferee causes damage to the owner negligently when acquiring ownership in such circumstances since the owner’s title is destroyed by the (negligent) good faith acquisition. Such a non-contractual liability law rule, however, would serve no purpose, of course, because while property law would assure ownership of the good faith acquirer, non-contractual liability law would impose an obligation to make reparation and therefore to transfer it back to the previous owner. Burdening the new owner with such an obligation would in large measure frustrate the aim of the property law rule. It must therefore be taken as implicit that such cases will not give rise to non-contractual liability. This is encapsulated by the rule in VI.–1:103 (Scope of application) sub-paragraph (c) which disapples the provisions of this Book where they would contradict the purpose of other rules of private law.

Stolen goods. The second problem arising from the possibility of acquisition of property in good faith in the absence of *gross* negligence is the exception sometimes made which completely excludes the possibility of acquisition in good faith where the property is stolen or has otherwise gone astray. Without an adjustment to the non-contractual liability law provisions one would arrive on the basis of such property law at the contradictory notion that a person who by mere negligence failed to appreciate the transferor’s lack of title, but neither knew nor should have known that the property had been taken from the owner, will be liable for destroying or damaging it, whereas such a person would become owner if the property has not been stolen, and would consequently not be liable for its subsequent destruction, this being the destruction of the person’s own property. The different outcome for the two cases is determined solely by whether the property is stolen (about the existence of which state of affairs the acquirer was not grossly negligent). Given that the acquirer’s state of mind is the same in both cases, there is a necessity to treat the two cases alike from a non-contractual liability law perspective. This involves extending to damage of stolen property for non-contractual liability law purposes only the protection granted by property law to the ‘merely’ negligent good faith acquirer of non-stolen property. VI.–1:103(c) (Scope of application) in

turn ensures that there is no resulting contradiction between non-contractual liability and property law.

Property rights in corporeal things. VI.–2:206 applies to immovable as well as movable property. Plots of land, houses and corporeal movable objects are “things” within the meaning of the Article. It does not, however, apply to incorporeal property. Intellectual property rights (copyright, patents, etc.) are subject to special legal regimes in all the Member States of the EU which are unaffected by these rules. The same is true for rights embodied in an instrument. The right “to” a bond is ownership in property within the meaning of VI.–2:206; the right “from” a bond is not.

Mere contractual or other relative rights excluded. Mere contractual or other relative rights are also excluded from the provision. That does not mean, though, that such rights are not capable of enjoying legal protection under the law on non-contractual liability. Rather it means only that the question whether one is faced with a legally relevant damage must be decided in the absence of a special regime (e.g. in VI.–2:211 (Loss upon inducement of breach of obligation)) according to VI.–2:101 (Meaning of legally relevant damage) paragraph (1)(c). Here again it can depend in particular on whether the injuring person acted intentionally or merely negligently. The practical result differs little from a concept whereby the presence of an infringement of a property right is assessed differentially based on whether the injuring person acted intentionally or negligently.

Illustration 3

A operates a hairdresser’s salon in house which is damaged by T with a lorry. Of necessity the business must be closed for a period. Two of A’s employee hairdressers sue on account of their loss of wages. They have neither suffered an infringement of any “property right” of theirs nor suffered an infringement of lawful possession in regard to the hairdresser’s salon nor become the victim of an inducement of their employer to fail to perform obligations towards employees. Had T however acted to cause loss intentionally – for example, by an act of vandalism – then the employees too would have suffered a legally relevant damage, though not under this Article or VI.–2:211 (Loss upon inducement of breach of obligation), but instead on the basis of VI.–2:101 (Meaning of legally relevant damage).

Illustration 4

A construction company carrying out road works negligently cuts through a subsurface electricity cable. Legally relevant damage is suffered as a result by the electricity company, which is the owner of the cable, but not by a business at whose head office work is consequently temporarily interrupted. The negligent impact on its contractual relationship with the electricity company does not establish legally relevant damage. The situation is different where as a result of the power cut, property is damaged or destroyed, e.g. heated metal cools down or (in a private household) the contents of a freezer are spoiled.

C. Lawful possession

Possession. For the purposes of VI.–2:206 “property rights” do not include lawful possession of corporeal things. For that reason lawful possession is given separate mention in paragraph (1). Possession as such is a mere state of affairs, not a right and thus not a property right. If,

however, possession is reinforced by a right to possession, then in accordance with paragraph (1) it likewise amounts to an interest protected by this rule.

Detention included. Mirroring the hitherto lack of a common European notion of ownership, there is to date no uniform European concept of lawful possession. In a range of legal systems the notion of possession only encompasses so-called “proprietary possession” (or, in relation to immovables, “owner occupation”) and thus only cases in which someone possesses the thing “as his own”. In these systems, therefore, even a lessee is not a possessor; but only a so-called detentor. In contrast, the category of detention is completely unknown in other legal systems. They use the term “possessor” also of a person who possesses “for another”. Consequently in these legal systems the complete opposite prevails: – a lessee is seen as the prototype of a possessor. VI.–2:206 does not seek to take a stand on this difference of views in property law; as stated above, the provision must therefore be adjusted at a later point in time to take on board more recent developments, as the need arises. Here it is only necessary to clarify that the notion of possession deployed by VI.–2:206 is to be understood as including detention. This readily follows from the protective aim of the rule: a proprietary possessor (i.e. a “possessor” in the sense of systems that distinguish between possession and detention) is either entitled to claim as an owner or falls completely outside this rule because the possessor would be a thief and would not have lawful possession.

Lawful possession. VI.–2:206 is not concerned with possession as such, but rather the right to possession. A thief does not fall within the provision’s scope of protection. The same goes for a possessor to whom the thing is unlawfully sub-let by its lessee; in any such case the sub-lessee has no right to possession as against the owner.

Several possessors. The legal protection which several possessors (or detentors) of the same thing are to enjoy in their relations to one another must be determined on the basis of the applicable national property law.

Property law protection of possession remains unaffected. It follows from VI.–1:103 (Scope of application) sub-paragraph (d) that VI.–2:206 does not affect remedies available on other legal grounds. Thus, to the extent that legal protection of possession is also provided for by property law and the injured person is equipped with a more favourable course of action under that regime, this will not be impinged upon by the parallel provisions of non-contractual liability law. The same is of course equally true for protection of ownership under property law, as the case may be.

Loss caused by infringement of lawful possession. Legally relevant damage within the meaning of VI.–2:206 is only loss resulting from the infringement of a right to possession of the thing. While that normally includes loss of use, it does not encompass loss resulting from harm to the thing’s substance.

Illustration 5

If a business traveller’s hired car is stolen, he has a claim against the thief to reparation of damage arising from having to hire another car. By contrast, however, the business traveller does not suffer legally relevant damage where someone damages the vehicle without adversely affecting its roadworthiness. It is the owner who is entitled to reparation on account of the property damage.

Illustration 6

A renovates B's apartment in an unauthorised fashion, despite the fact that B is not at all in agreement with this. B therefore restores the apartment to its previous state. The costs of restoration constitute recoverable damage.

D. Infringement

The concept. Paragraph (1) invokes a broad concept of infringement of another's property right. Another's property right is infringed where a person uses the property in a manner solely befitting the holder of the property right. The most important cases of infringement of a property right are enumerated in paragraph 2(b). The cases listed there are not, however, exhaustive ("includes").

Illustration 7

A accepts B's request to bring a picture bought by B in London back to Munich – the place of residence of both A and B – on A's return journey. A carelessly leaves the picture unattended at the airport and it is stolen. A has infringed B's property right (by omission), although A has neither damaged the picture, nor disposed of it, nor occasioned an interference with use or other disturbance of the exercise of B's right.

Defences. The concept of infringement operates independently of the existence of a defence. It is based on a "factual" concept to that extent. Someone who is attacked by another's dog and injures the dog in self-defence "infringes" the property rights of the dog owner, but is not liable to the dog owner (VI.–5:202(1) (Self-defence, benevolent intervention and necessity)). The same is true for an insurance fraudster who, with the assent of the owner, drives the latter's car in order to stage an accident: VI.–5:101 (Consent and acting at own risk) does not change the fact that this concerns property damage.

E. The most important modes of infringement of another's property right (paragraph (2)(b))

Damage to property. Typical infringements of property rights consist of the destruction or damaging of the subject-matter to which the property right relates. The wording of the text therefore employs for this purpose (and solely for this purpose) the expression "property damage", to which reference is made in later Articles. This relates in particular to VI.–3:202 (Accountability for damage caused by the unsafe state of an immovable) and VI.–3:206 (Accountability for damage caused by dangerous substances or emissions), from which it follows that the "strict liability" regulated there is not tailored to infringements of property rights of every kind, but only to infringements of property rights in the form of damage to property.

Ineffectual products. Property damage can also be the result of an ineffectual protective measure and in particular an inoperative product.

Illustration 8

A obtains for use on fruit plantations a fungicide which should prevent the natural fungal infestation of apples. It does not do what it says on the tin. The apples get worse and prove to be unmerchantable. This is loss resulting from property damage.

Self-contained damage in defective products and buildings. One case of property damage which is excluded from this Article, though not alluded to in the text, is where damage results to the entirety of a product or spreads to other parts of a product as the result of a defect within it. As regards strict liability, the matter is governed exhaustively by the EU Directive on product liability to the effect that strict liability is excluded (see VI.–3:204(1) (Accountability for damage caused by defective products)). With regard to negligence-based liability the matter will reside exclusively within contract law. That follows from VI.–1:103 (Scope of application) sub-paragraph (c): see comments on that rule. The provisions of non-contractual liability law do not apply if they would contradict other rules of private law. That would be the case in respect of damage to the product itself because the application of VI.–2:206 would have the effect of displacing or making inroads on contract law rules on liability. Consequently, VI.–2:206 will only apply where the impairment to property caused by a defective product is damage to property other than the defective product itself.

Sale of land. Comparable problems can also arise in regard to the sale of land. They concern the same general problem of concurrence of actions in relation to the law of contract and the law on non-contractual liability and they must therefore be resolved likewise on the basis of VI.–1:103 (Scope of application) sub-paragraph (c).

Disposition of the right. An infringement of property rights can of course also occur where the thing itself remains undamaged. An important example of this type of case relates to the disposition of another's property. This is because a disposition of the property may amount to its destruction in economic terms if, as a result of a third party's acquisition of title in good faith, this brings about a loss of ownership. The position is quite similar where, as a result of the injuring person's disposition, a third person acquires a limited right in rem in respect of the owner's property.

Illustration 9

A acquires goods from B under reservation of title. B does not consent to their resale or consents only under certain conditions, such as A transferring to B his claims to payment from his sub-purchasers. A does not comply; his sub-purchasers acquire title in good faith. Besides a non-performance of a contractual obligation, there is also the causation of damage relevant to the law on non-contractual liability. B therefore (under certain circumstances) also has a non-contractual (but not a contractual) claim to damages directly against C, the managing director of A, a legal person.

Illustration 10

A hired an item from B and pawned it to X, to whom it is handed over. In view of her good faith assumption as to A's title, X has acquired a security right burdening the property which is also effective against B. A has caused an infringement of B's ownership.

Law of unjustified enrichment. Concurrent liability under the law of unjustified enrichment remains unaffected by non-contractual liability for damage under this Book: see VI.–1:103 (Scope of application) sub-paragraph (d). This is of particular significance where the disponent neither acts intentionally nor negligently disregards the owner's title.

Interference with use. An infringement of a property right is also made out when the owner's use of property is disturbed. This is obvious for immovable property, but it also occurs frequently in cases of movables.

Illustration 11

Destroying the ordered system of an archive, warehouse, stamp collection or files in an office does not amount to property damage because the individual items remain undamaged and because, in any event under most legal systems, there is no property in the archive (etc.) as such. However, there is an infringement of a property right in the form of a detrimental interference with use.

However, transient interferences with use of the sort that permanently occur in daily life will not suffice. That follows from VI.-6:102 (De minimis rule).

Illustration 12

Where a person parks a vehicle in a city for a short time in such a way that another vehicle is hemmed in, no infringement of property is committed. The situation is different where a car is blocked for days on end or where a ship (which docked for unloading) cannot leave a canal harbour for over half a year due to the collapse of a negligently and inadequately secured retaining wall.

Deprivation of use: infringement and loss distinguished. Paragraph 2(b) states that interferences with use amount to an infringement of property rights; conversely, paragraph 2(a) takes up the loss of use resulting from an infringement of a property right. Both aspects are to be differentiated. Paragraph 2(a) requires an infringement of a property right, regardless of the kind of infringement. Property damage provides the typical example. Paragraph 2(b), in contrast, makes it clear that interference with use as such can constitute an infringement of the property right of another.

Other disturbance of the exercise of the right. Other disturbances of the exercise of property rights, which do not take the form of property damage, the loss of a right or an interference with use but nonetheless amount to infringements of property rights, are equally numerous. Frequent examples include thefts, misappropriation and trespass.

Illustration 13

A, the owner of historical castle grounds, forbids visitors from taking photographs in the interior, as she wants to make a small additional income from the sale of postcards and the like. It is to be used for the upkeep of the site. A commercial photographer does not comply with the ban and subsequently offers his own postcards for sale to tourists. The photography of the rooms constitutes an infringement of property rights.

F. Loss

General. VI.-2:206(1) makes it clear that losses which result from an infringement of a property right constitute legally relevant damage. Typically these take the form of costs of repair, the subject-matter of the property right having been physically damaged, and a loss of profit because the claimant has been deprived of the opportunity to exploit the property commercially. These losses are already covered by the general rule in VI.-2:101 (Meaning of legally relevant damage) paragraph (1) in conjunction with (4)(a), and the same holds true for a reduction in the value of property. If a thing is damaged, then the property right which subsists in relation to that thing loses value. (The case differs only if, for example, the thing affected is a building which is standing empty and destined for demolition and damage arises through children throwing stones to break the window panes, see comments above.)

Depreciation in merchantable value. A not uncommon case is where a complete repair or restoration will not in fact eradicate entirely the loss of value which has arisen. In such cases there must be compensation for the residual loss of value in addition to the repair costs.

Illustration 14

A's vehicle is damaged in a traffic accident. While it can be fully repaired, it nevertheless loses value because a so-called "accident damaged car" will sell for less on the used car market than an otherwise identical, but accident-free car. This so-called "depreciation in merchantable value" is recoverable loss, which must be compensated in addition to the repair costs.

Non-economic loss. As regards non-economic losses, it equally follows from the general rule contained in VI.-2:101 (Meaning of legally relevant damage) paragraph (1) that they are also recoverable in principle, as long as the other requisites of liability under VI.-1:101 (Basic rule) are fulfilled. The affirmation of legally relevant damage in the form of non-economic loss caused by an infringement of property rights is particularly self-evident where there is an intentional infringement of property rights, which was orchestrated purely to inflict mental pain on the owner. An example would be where a person intentionally shoots another's pet, whose death causes distress to the pet owner. VI.-2:206 is not of course restricted to such cases. It is not necessary that the injuring person should want to inflict mental suffering on the owner. Instead liability for non-economic losses as a rule falls to be considered whenever an intentional infringement of property has taken place. Whether or not the injuring person intended to cause mental suffering will not affect liability, provided the injuring person intended to cause the infringement of the claimant's property right (the act of destruction) whose consequential loss constitutes the damage, meaning to inflict that property damage on the owner. A case in point would be where a burglar disrupts possessions in the dwelling which he has broken into and it is this violation of the home owner's rights which causes distress: the burglar, intent on finding and stealing any valuables he finds, means to infringe the owner's property rights when he disturbs the owner's belongings; he need not intend to cause distress, but it suffices that this is the result of his intentional infringement. Conversely, in cases of purely negligent infringements of property rights, a precise assessment is to be carried out as to whether the alleged non-economic losses have actually occurred. Such liability is not ruled out in these cases, but a more precise analysis of the consequences of the infringement of property rights is demanded. A run-of-the-mill traffic accident involving physical damage to a standard vehicle cannot be seen as the cause of non-economic loss (see VI.-4:101 (General rule [on causation])).

Deprivation of use (paragraph 2(a)). However, other forms of loss beyond the ones already mentioned may also arise. Of these one form is explicitly mentioned in paragraph (2)(a), namely, a deprivation of the benefits of using or being able to use property. This constitutes a loss and thus a legally relevant damage. Withholding property from another or preventing others from using their property, in other words, can constitute both an "infringement" (sub-paragraph (b)) as well as a "loss" (sub-paragraph (a)).

Illustration 15

Consider the case where property (in particular a motor vehicle) is damaged and not available for use during the period of repair. In that case damage is not merely present when the person affected must procure a substitute and must incur the expense of using public transport. Rather the loss of *potential* use – the loss of the benefit which

the property right would otherwise have assured - is in itself a legally relevant damage. It does not matter that the use which would have been made of the vehicle would have been for pleasure, rather than for business. That avoids a differential treatment of property which is not deployed by the owner in a profit-earning capacity. If a taxi is damaged, the owner can naturally claim the profit foregone during the period of repair or the cost of procuring a new vehicle; a private individual ought to have a corresponding claim on account of the loss of the opportunity to make use of the car whenever so desired, which necessarily looks towards the latter of these two measures of loss. Given the absence of actual economic loss of profit, the measure of the loss referred to in paragraph (2)(a) will generally be a substantial part of the cost of hiring a substitute vehicle (even if that is not done), because that approximates the value of the use of which the injured person was deprived. However, it is of course a requirement that the claimant wanted to make use of the property right or was at least able to do so.

Illustration 16

Youths occupy an empty house in a university town. They infringe the property rights of the house owner (paragraph 2(b)) and occasion loss to the owner in the amount of the estimated rental value of the house; they are still liable even if the owner cannot prove that during their period of occupancy a tenant willing to pay rent was dissuaded from renting.

Cable cases. In other words sub-paragraph (a) concerns situations in which it cannot be said that there is legally relevant damage simply on the basis of VI.-2:101 (Meaning of legally relevant damage) paragraph (4)(a). VI.-2:206(2)(b) on the other hand does not provide any clarification as to the concept of a loss. Rather VI.-2:206(2)(b) describes the forms of infringement of property rights and makes the (essentially obvious) point that a deprivation of use is numbered among them.

Illustration 17

The so-called cable cases (see illustration 4 above) were not concerned with either an infringement of property within the meaning of paragraph (2)(b) (the owner of the machine is admittedly cut off from electricity, but is not hindered in the use of it or otherwise disturbed in the exercise of the right) nor with loss in the sense of paragraph 2(a) (which would need to be assessed if, for example, property damage were caused as a result of the interruption in power supply). The loss lies in the expense of repair, a fall in value and lost profit, not in the loss of use as such.

VI.-2:207: Loss upon reliance on incorrect advice or information

Loss caused to a person as a result of making a decision in reasonable reliance on incorrect advice or information is legally relevant damage if:

- (a) the advice or information is provided by a person in pursuit of a profession or in the course of trade; and*
- (b) the provider knew or could reasonably be expected to have known that the recipient would rely on the advice or information in making a decision of the kind made.*

COMMENTS

A. General

Policy considerations. As a general principle there is no liability for advice, recommendation and information. Any such liability would go too far to be workable for daily life and would burden every interpersonal communication with an unbearable risk of liability. The case is otherwise only when the recipient of the information has special cause to rely on the correctness of the information and the provider of the information knows or should know about this special situation in which the recipient of the information is placed. Typical cases concern information about credit-worthiness provided by banks and faulty valuations or certifications. Further instances would be instructions on use which a producer encloses with a product for the guidance of the end consumer or where a certifying authority issues digital signatures. However, the provision can also have effect in the realm of legal liability of doctors and other professionals.

European community law. As regards the special rules for internet service providers see comments under VI.–2:204 (Loss upon communication of incorrect information about another). In contrast to the Directive on Electronic Commerce (2000/31/EC), the Directive on the prospectus to be published when securities are offered to the public or admitted to trading 2003/71/EC (OJ L 345 of 31 December 2003) has left the civil liability of the publisher of the prospectus unaffected (loc. cit. art. 6).

Relationship to contractual liability. Like all rules in this Book, VI.–2:207 is related to non-contractual liability. In some of the cases covered by VI.–2:207 a liability in contract may also arise. See further Book IV Part C. (Services). It is possible that contract law may undergo further developments whose effect will be to buttress or overlap with VI.–2:207 to a not insignificant extent. Whether in a particular case a parallel liability in non-contractual liability ought to be excluded must then be determined by contract law (VI.–1:103 (Scope of application) sub-paragraph (c)). However, the text proceeds on the basis that in cases comparable to the English decision in *Hedley Byrne v. Heller* [1964] A.C. 465 (concerning a credit reference provided by a bank in response to the third party's inquiry whether the bank's customer would be in a position financially to discharge obligations under a prospective transaction) a contract solely containing an obligation of the bank to be liable in the event of the information being incorrect would not arise. That is because there is no unilateral promise.

Relationship to VI.–2:204 (Loss upon communication of incorrect information about another). Whereas VI.–2:204 (Loss upon communication of incorrect information about another) governs legally relevant damage in case of incorrect information communicated to a third party, VI.–2:207 governs damage in case of incorrect information communicated to the recipient. VI.–2:207 thus concerns the question when does a recipient of false advice or information suffer a legally relevant damage if suffering loss by relying on that advice or information. It does not concern the situation in which false information is given *about* the claimant to a third party.

Illustration 1

If in deciding to make a (detrimental) tax-privileged capital investment a dentist relies on the incorrect information which an accountant and tax consultant has given the dentist orally, in a letter or in a brochure, the resultant loss will be legally relevant damage within the meaning of VI.–2:207. If it is reported that the dentist is evading

tax, the matter falls within the ambit of VI.-2:204 (Loss upon communication of incorrect information about another).

B. The circle of protected recipients of the information

Professional advice or information. Not every provision of information and advice which is defective and relied on by the recipient to the recipient's detriment can lead to liability under this Article. The damage must be caused by provision of information "in pursuit of a profession or in the course of trade". So-called 'kerbstone' advice falls outside those terms because provision by a professional is not enough; what is required is provision of the defective information or advice in the course of carrying out the profession. In the usual case this will mean in the context of a business activity, albeit irrespective of whether that is remunerated and whether there is a pre-existing contractual relationship with the recipient.

"The" recipient, not "a" recipient. The recipient of the information may be either a private individual or a person engaged in a business, trade or profession and may be either a natural or a legal person. The provision does not apply, however, to just any incidental recipient of the information who happens to rely on the correctness of the message that has come to that recipient's attention. The matter does not turn on whether the person communicating the information knew or ought to have known that somebody at least would rely on the information. What is essential is rather that that person must have had a definite circle of persons in view (sub-paragraph (b)). The person who gives the information or advice certainly need not know the actual recipient. An anonymous recipient suffices. Nor is it necessary that the recipient received the defective information or advice from the provider directly. An indirect recipient who obtains the information through intermediate third parties may equally have a claim. However, in both such cases the claimant must belong to the class of potential recipients of the information whose members the provider of the information knew or ought to have known would be dependent on the corrections of that information in coming to a decision of substantial significance and would rely on it. A person who does not reach a business appointment due to an incorrect traffic congestion report does not suffer legally relevant damage.

C. Reliance

Reasonable reliance. The existence of relevant damage for the purposes of the law on non-contractual liability arises crucially out of the disappointment of a legitimate reliance. It does not suffice that the recipient of the information actually relied on its correctness. This must be accompanied by the element that in the circumstances and in relation to the decision to be made, the recipient might reasonably rely on the information. A reasonable reliance on the accuracy of the information or advice is missing if one has trusted the utterances of a fortune teller, astrologist or similar charlatan. The recipient of information may also not rely on it if the recipient knows or should know that the provider of the information does not wish to vouch for the correctness of the communication.

Illustration 2

The element of justifiable reliance is therefore missing if the providers of the information makes it explicit that they do not or cannot accept responsibility for the correctness of the information (e.g. by making use of a "without obligation" clause or similar formulation).

Foreseeability of reasonable reliance. The requirement that the provider should have foreseen reasonable reliance on the advice or information provided (sub-paragraph (b)) will

also operate to qualify implicitly the types of decision which can result in a loss relevant to VI.-2:207. The claimant must show that the provider ought to have foreseen that (i) the injured person would have made a decision of the type in fact made and (ii) would make such a decision in reliance on the information or advice provided. It is inherent in the foreseeability of such (reasonable) reliance on the information or advice that a decision of the sort made will be a significant one. The more serious the decision, the more the recipient's need for expert insight and correspondingly the greater opportunity for dependence on another's provision of expertise because of the informational imbalance between the parties. Conversely, the more trivial the decision, the less the grounds for supposing that the recipient would depend on the information given and the greater the reason for assuming that the recipient would not be strongly influenced by it. An information provider can safely expect others to make trivial decisions under their own steam and not to act parasitically on the guidance of others.

Illustration 3

Representatives of a regional agency of an *association pour l'emploi dans l'industrie et le commerce* hold an information session on the terms of early retirement annuities in the rooms of the claimant's employer. The claimant relies on this information; the damage that is caused to her as a result of her leaving the working world on the basis of too generous statements of her prospective pension is legally relevant damage. The *association* is liable if negligence is attributed to its representative. Contributory fault on the part of the claimant leads to a reduction in the claim to reparation.

D. Incorrect advice or information

An inseparable composite term. The subject-matter of VI.-2:207 is loss as a result of decisions that are attributable to "incorrect advice or information". This term does not denote two separate events (*either* advice *or* information), but rather a single activity in which an assertion of fact blends with a recommendation to make a decision based thereon. Mere advice ("travel by train, not by car") taken on its own lends itself just as little to being qualified as "right" or "wrong" as a mere value judgement. The advice must be based on a core of fact. On the other hand, a pure assertion of fact is likewise no sufficient basis for ascribing decision-making to that assertion. Instead a combination of both elements, for instance the (false) statement that the required planning permission for a piece of land had been given, coupled with at least the implicit recommendation to opt for the acquisition of that land. Mere conjecture is no assertion of fact.

Causation. VI.-2:207 operates with a two-pronged requirement for causation. The incorrect advice or information must have been a cause of the affected party making the relevant decision and this must in turn be seen as a cause of the loss. In each case, so-called "psychological causation" is in issue, which can be ascribed to an omission by the party responsible.

Illustration 4

A firm of accountants negligently overlooks considerable book losses while auditing a company's balances. Relying on the report, private persons invest in the audited company, which shortly afterwards goes into liquidation. The firm of accountants is liable to the investors for the price paid for the shares.

Accountability. VI.-2:207 relates only to the question of the prerequisites for the affirmation of legally relevant damage. As with all the provisions of this Section, it does not constitute a complete norm of liability. In particular it remains to be examined, whether the provider of

the information acted negligently and whether contributory fault may be attributed to the recipient of the information in not having verified the information.

VI.-2:208: Loss upon unlawful impairment of business

(1) Loss caused to a person as a result of an unlawful impairment of that person's exercise of a profession or conduct of a trade is legally relevant damage.

(2) Loss caused to a consumer as a result of unfair competition is also legally relevant damage if Community or national law so provides.

COMMENTS

A. Purpose and scope

Purpose. The purpose of this provision is to make it clear that loss resulting from an unlawful interference with another's business or profession constitutes a recognised damage for the purpose of the law on non-contractual liability. It concerns losses as a result of prohibited interferences with competitors' access to the market. Falling outside its remit, therefore, is the question whether and under what circumstances a consumer too can claim reparation from an undertaking that has caused him or her a loss by an unfair competitive practice (paragraph (2)). This problem area is the subject-matter of a self-contained branch of law in many (if not in all) European legal systems; today, only exceptionally is it still located in the general law on non-contractual liability.

Prevention. In the situations covered by this Article, it is not only compensation for losses suffered which plays a role. Preventative legal protection is also of great practical significance here. For that reason particular regard is to be given to VI.-1:102 (Prevention) and VI.-6:301 (Prevention in general).

Scope. The Article borrows in part from the concept developed in German non-contractual liability law of a "right to form and operate a business enterprise" (or "right to enterprise"), but does not correspond with its scope of application in every regard. In particular, VI.-2:208 is narrower because it is silent on the legal liability arising from unauthorised forms of labour disputes: see VI.-7:104 (Liability of employees, employers, trade unions and employers associations). Due to VI.-7:104, all cases of "harassment" of fellow-employees also remain unaffected by VI.-2:208. The so-called "jeopardising of credit-worthiness" recognised in many legal orders is covered by VI.-2:204 (Loss upon communication of incorrect information about another). VI.-2:211 (Loss upon inducement of breach of obligation) provides for another special rule for legally relevant damage arising from inducing non-performance of a contractual obligation. On the other hand, VI.-2:208 markedly goes beyond the concept of the "right to form and operate a business enterprise" referred to above in so far as the provision also gives effect to the general proposition that a market participant's losses as a result of any unauthorised competitive behaviour of a competitor constitute legally relevant damage.

Groups of cases covered. Cases which may fall under VI.-2:208(1) may, therefore, involve industrial espionage, boycotts and (other) activity in contravention of competition law including the law against cartels or the abuse of dominant positions, and the law against unfair

commercial practices such as wrongful advertising. True assertions about a competitor can also fall under VI.–2:208 if they have no intrinsic connection to the substance of the competitor’s commercial activity and therefore are only made in order to scare away potential or current customers. Of further note are e.g. product piracy and cases of unlawful warning to a rival or a rival’s customers with the false claim that the rival’s products infringe an industrial property right of the person giving the warning.

Illustration 1

Company X asserts that the sanitary fittings manufactured by company Y are infringing its three-dimensional trademark and seeks a court order prohibiting Y from marketing the fittings. In the ensuing trademark law dispute, X’s trademark is deleted from the trademark registry with retroactive effect for lack of any distinctiveness. The losses that Y suffers as a result of the temporary discontinuation of the marketing of their sanitary fittings represents legally relevant damage, which must be compensated if X acted intentionally or negligently.

Infringement of EU competition law. Under VI.–2:208 legally relevant damage is also constituted by losses that are inflicted upon an undertaking through a competitor’s breach of EU competition law. According to the case law of the ECJ, Member States must provide for such a claim for reparation. Even a person who was party to the anti-competitive agreement may invoke the protection of Community Law, unless this would amount to rewarding it for its own unlawful conduct (ECJ 20 September 2001, C-453/99, ECJ Rep. 2001, I-6297, *Courage*). The legal discussion as to whether such a claim for reparation should depend on fault or be independent of fault has just begun (Commission of the European Communities, Green Paper – Damages actions for breach of the EC antitrust rules, COM(2005) 672 final). Under these rules, negligence is required as a minimum according to the general rules (VI.–3:102 (Negligence) in conjunction with VI.–1:101 (Basic rule)).

B. Unlawful impairment of profession or trade

Profession or trade. The cause of the damage is an unlawful impairment of another person’s exercise of a profession or conduct of a trade. The formulation “profession or trade” ensures that not only trading companies (regardless of their legal form), but also other working persons, whether they engage in trade or not, fall within the provision’s scope of protection.

Illustration 2

A company offers medical services without the necessary governmental licence. It calls its business “Polyklinik” and advertises in a catalogue of an international travel operator with a logo similar to the Red Cross with the slogan “medical aid wherever it is needed, first line of human assistance day and night.” The advertisement violates the legislation of all the countries in which the company operates its business. The doctors who work in the vicinity of the “Polyklinik” may seek a court order prohibiting the business and the advertisement. The advertising material must be withdrawn.

Exercise of a profession. The term “exercise” of a profession was chosen in order to make it clear that the provision protects not merely existing professional activities but also a person who has not yet commenced a professional activity but is unlawfully hindered in doing so.

Illustration 3

In applying for a position, a doctor claims credit for a scientific study carried out by someone else, as a result of which a competing applicant loses out. The competitor

suffers legally relevant damage. The competitor's non-economic loss is also recoverable.

Impairment. An "impairment" of another's exercise of a profession or conduct of a trade is sufficient because it is the unlawful harming of business which is at stake; its complete destruction or obstruction is not essential.

Illustration 4

The personnel of several tugboats are incited not to tug out of the harbour the claimant's tankership which sails under a flag of convenience. There is an unlawful impairment of the claimant's business.

Unlawful impairment. The interference must be unlawful, i.e. contrary to either statutory provisions or established practice, the latter including rules of correct conduct developed by the courts. "Unlawful" incorporates into the draft the benchmarks of both European Community law and the relevant individual jurisdictions in the Member States. An interference directed at the business or occupational activity of the claimant is required. It must involve an impairment of either the right to access the market or the right to compete on the market under fair conditions for customers. Purely accidental (even if possibly severe) consequences of an act which, according to its nature, is not directed at another's freedom of business is insufficient.

Illustration 5

In the so-called "cable cases" (see illustration 4 under VI.-2:206 (Loss upon infringement of property or lawful possession)), an unlawful impairment of another's business is absent even where production is at a complete standstill for some time.

Unfair competition to the detriment of competitors included. An unlawful impairment of another's business within the meaning of paragraph (1) is also present in cases of unfair competition to the detriment of a competitor. Account has been taken of the fact that there is at present no common concept in Europe of what is "unfair competition". In addition, some legal systems operate in this area, for want of a special regime, with the general law on non-contractual liability, while others have addressed this field either completely or partially with special statutes. It did not therefore seem appropriate to exclude the law of unfair competition with regard to business to business relations from the Article's scope of application. However, wherever specific rules intend to provide an exclusive regime for the law against unfair competition they have priority of application over VI.-2:208(1). That follows from VI.-1:103 (Scope of application) sub-paragraph (c).

Unfair competition to the detriment of consumers excluded. Paragraph (2) follows the approach adopted for VI.-2:203 (Infringement of personal dignity, liberty and privacy) paragraph (2). A loss which a consumer suffers due to the unfair competition of a business is only a legally relevant damage according to these rules if Community or national law so provides – in other words, if the consumer (and not merely competing businesses) come within the scope of protection of the law on unfair competition. Consequently, the Article does not address the question whether consumers or consumer associations can assert claims on the basis of a business's unlawful anti-competitive acts. This question remains to be answered by national (substantive or procedural) law.

VI.–2:209: Burdens incurred by the State upon environmental impairment

Burdens incurred by the State or designated competent authorities in restoring substantially impaired natural elements constituting the environment, such as air, water, soil, flora and fauna, are legally relevant damage to the State or the authorities concerned.

COMMENTS

A. Pure ecological damage

Directive 2004/35/EC on environmental liability. VI.–2:209 latches on to the autonomous legislation of some of the Member States, while at the same time inserting two core messages of Directive 2004/35/EC of the Council and the European Parliament of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage (OJ L 143, 30 April 2004, p. 56-75) into the structure and language of these basic rules: (i) ecological damage is legally relevant damage. It is, however, (ii) not legally relevant damage to the individual in the sense that each citizen can claim reparation for it. Environmental impairments may – depending on the point of view – also infringe individual rights to the environment, but as a matter of the law on reparation they are only recoverable in their capacity as damage to a legally protected interest, to which all citizens are entitled indivisibly. Hence only public authorities can claim compensation for such damage (under the general prerequisites of VI.–1:101 (Basic rule)). This accords with recital no. 14 to that Directive which reads: “This Directive does not apply to cases of personal injury, to damage to private property or to any economic loss and does not affect any right regarding these types of damages.” Incorporating this, Directive 2004/35/EC art. 3(3) specifies: “Without prejudice to national legislation, this Directive shall not give private parties a right of compensation as a consequence of environmental damage or of an imminent threat of such damage.” Consequently, Directive 2004/35/EC art. 8 only grants a claim for recovery of costs to the “competent authority” and not to private parties. This formulation is also to be found in VI.–2:209. Under Directive 2004/35/EC art. 19, the Member States are obliged to implement the Directive by 30 April 2007.

Public and private law. This Article lies on the border between private and public law. Its characterisation as a creature of public law stems from the element that pure environmental damage becomes legally relevant solely from the perspective of the public – the state or a competent authority (and so therefore only the state can enforce a claim to reparation). On the other hand, the rule also has the exact opposite function in saying that private law subjects do not normally suffer any legally relevant damage from detriment resulting from pure environmental damage (e.g. the loss of quality of life springs to mind, but also, for instance, for hotels or petrol stations, the absence of tourists). This second statement in the Article is certainly one of private law. Ultimately, however, the question of characterisation must remain open here. This is so not only because to date there are no criteria accepted across Europe for the theoretically “correct” demarcation between public and private law, but also because in this instance the question is wholly irrelevant. Rather the critical point is that compensation for the expense of redressing environmental damage follows categories of civil *liability* and not those of public order. In other words, the Article is formulated as if it related to a normal private law claim under non-contractual liability law. This is shown not just by the prerequisites for a claim, but also by the defences to it (such as e.g. force majeure, see VI.–5:302 (Event beyond control) or Directive 2004/35/EC art. 4) and the applicability of the rules on causation and compensation.

B. Legally relevant damage and accountability

Damage to individuals and damage to the society at large. The object of this Article is, as already mentioned, to assert that so-called “pure ecological damage” constitutes legally relevant damage. This is a damage suffered by the public at large, rather than by particular individuals. However, the Article is not concerned with damage which natural persons or legal persons constituted under private law may suffer as a result of an impairment of the environment. Such forms of damage constitute legally relevant damage if (but only if) the conditions of the preceding Articles of this Chapter are fulfilled. From the individual’s point of view it is a matter of indifference whether a personal injury or property damage, for example, has been caused by some run-of-the-mill incident such as a road accident or by an environmental catastrophe. Infringements of property rights and bodily injury invariably remain legally relevant damage to the individual, regardless of how they are caused. Conversely, genuine environmental damage is collective damage; this Article is concerned exclusively with the latter.

Environmental organisations. The Article also makes it clear that the collective damage it covers is not legally relevant damage to the detriment of environmental protection organisations constituted under private law or any other associations. Notwithstanding the fact that they have devoted themselves to environmental protection, no legally protected interest of their own is affected. This does not exclude national arrangements under which authorities at least partially cede the pursuit of environmental interests to such organisations (cf. Directive 2004/35/EC arts. 11(3) and 12(1)). On the other hand this very possibility shows how difficult the demarcation between public law and private law is within this overall matrix.

Relationship to VI.–3:206 (Accountability for damage caused by dangerous substances or emissions). As regards accountability for damage a special rule has been formulated in VI.–3:206 (Accountability for damage caused by dangerous substances or emissions). In contrast to VI.–2:209, which only specifies that expenses for the elimination of pure environmental damage are legally relevant damage, VI.–3:206 relates to the attribution as well as the causation of both individual and collective forms of damage within the meaning of VI.–2:209. Naturally, the State can also assert a claim under VI.–1:101 (Basic rule) in conjunction with VI.–3:206 in its capacity as the holder of an individual right (e.g. as the owner of a forest); that it has sustained a legally relevant damage results in such cases from VI.–3:206 in conjunction with VI.–2:206 (Loss upon infringement of property or lawful possession) and not from VI.–3:206 in conjunction with VI.–2:209.

VI.–3:207 (Other accountability for the causation of legally relevant damage). With regard to the issue of attribution (independent of legally relevant damage), reference should also be made to VI.–3:207 (Other accountability for the causation of legally relevant damage) sub-paragraph (b): as soon as all Member States have implemented Directive 2004/35/EC, attribution will first and foremost follow the national laws implementing the Directive.

C. Other matters

Expenditure incurred by private persons. The Article is silent on the issue of whether a private person (or a legal person constituted under private law, i.e. a NGO) who (or which) has for good reason incurred expenditure in order to eliminate environmental damage, can claim compensation from the person who is responsible for the environmental damage. From the point of view of non-contractual liability law, this question will usually be answered in the negative, whether that be due to the lack of legally relevant damage, or a denial of causation

because the affected party deliberately incurred exposure to the risk of loss or injury. The answer is thus to be sought in the law on benevolent intervention. This relates, for example, to the costs of cleaning prompted by environmental damage before the responsible public body or professional services are able to intervene. The advantage of this solution is that the claim to reimbursement of expenditure is linked in this way to the general requirements of the law on benevolent intervention in another's affairs. That in turn means that a right to reimbursement is excluded in respect of rash or unreasonably extensive intervention.

Environmental impairment. Directive 2004/35/EC art. 2(1) defines what is to be understood by the term environmental damage. VI.–2:209 refers to this definition by means of a mere summary of the essential elements of that definition in a language tailored to these rules .

The State or designated competent authorities. The text also draws on the Directive with the formulation that the damage described in VI.–2:209 is legally relevant damage “to the State or designated competent authority”. However, it appeared inexact to rely only on the “competent authority”, as the Directive does, because mostly it is not the authority, but rather the representative regional administrative body, that will suffer the damage.

Burdens incurred and loss in preventing damage. “Burdens” are expenditure for the redress of environmental damage. Thus, the cost of restorative measures is at issue. On the other hand, expenditure made before the injurious event occurred and frustrated by the injurious event is in principle non-recoverable damage. Examples here would be the high costs of the renaturalisation of a particular species of animal whose population is wiped out once more. Frustrated expenditure may, however, serve as an indicator for the assessment of the amount of restorative costs (in this case: the resettlement of the animals). The costs of preventing further threatening environmental damage are subject to the general rule in VI.–6:302 (Liability for loss in preventing damage).

VI.–2:210: Loss upon fraudulent misrepresentation

(1) Without prejudice to the other provisions of this Section, loss caused to a person as a result of another's fraudulent misrepresentation, whether by words or conduct, is legally relevant damage.

(2) A misrepresentation is fraudulent if it is made with knowledge or belief that the representation is false and it is intended to induce the recipient to make a mistake.

COMMENTS

A. The legally relevant damage

General. This Article contains the proposition – essentially self-evident for all non-contractual liability law systems – that losses as a result of fraudulent misrepresentation are legally relevant damage. In practice, however, claims for damages for fraudulent misrepresentation (*actio de dolo*) do not arise very often in most jurisdictions. This is because fraudsters are in many cases economically incapable of fulfilling their obligation to compensate and personal liability insurance does not provide cover in cases of intentionally committed wrongs.

Relationship to VI.–2:204 (Loss upon communication of incorrect information about another). The present Article operates “without prejudice to the other provisions of this Section”, thus leaving especially VI.–2:204 (Loss upon communication of incorrect information about another) and VI.–2:207 (Loss upon reliance on incorrect advice or information) unaffected. VI.–2:204 addresses losses resulting from the dissemination of false information about the injured person to third parties. Overlap with the present Article is less likely here. However, both Articles may apply in one and the same case for the benefit of different injured parties.

Illustration 1

In order to prevent a competitor B from “remaining in business” with a mutual customer C, A tells B that C is embroiled in a bribery scandal. B consequently refrains from concluding a contract with C, as originally planned. The losses B suffers are legally relevant damage within the meaning of the present Article, while C suffers legally relevant damage within the meaning of VI.–2:204 (Loss upon communication of incorrect information about another).

VI.–2:207 (Loss upon reliance on incorrect advice or information). The present Article differs from VI.–2:207 (Loss upon reliance on incorrect advice or information) essentially on the point that the present Article relates to losses caused by misinformation outside professional or trade activity. In private life, false advice and misinformation remain in principle without consequence in the law of liability. It is only actual deception which gives rise to liability. The latter also naturally applies to working life. As a result, it can arise that one and the same loss constitutes legally relevant damage within the meaning of these two Articles. Of course, as always in such cases, this does not alter the fact that the injured person can only have the damage satisfied once.

Loss. The legally relevant damage within the meaning of this Article will often take the form of so-called “pure economic loss”, i.e. loss which is independent of injury to the person or damage to property and which is equally independent of an infringement of some other right. Pure economic loss in this sense is suffered by any person who is induced by a fraudulent misrepresentation to enter into a disadvantageous contract. The fact that rules on the compensatory consequences of such deceit are to be found in II.–7:214 (Damages for loss) does not conflict with a concurrent application of non-contractual liability law: the fraudster has no claim to protection by insistence on a rule of contract law which is potentially more favourable: see VI.–1:103 (Scope of application) sub-paragraph (c).

Non-economic losses. The Article is not, however, restricted to specific forms of loss; consequently, non-economic loss in particular constitutes legally relevant damage within the meaning of this provision. That relates not only to cases of deception, causing suffering on the part of the victim, but to all intentional infliction of detriment through fraudulent misinformation for the purpose of inducing a mistake on the part of the affected party.

Illustration 2

X, having a peculiar sense of “humour”, knocks on his neighbour N’s door and informs her that her husband has had a severe accident and is in the intensive care unit of the hospital. N makes her way to the hospital with great anxiety, where she is told that her husband is not there. Nothing at all had happened to her husband; X has taken the liberty, as he says, of making a “joke”. N has suffered not only economic loss due

to the travel expenses, but also primarily recoverable non-economic loss arising out of her anxiety, and this is so even where the requisites of VI.–2:201 (Personal injury and consequential loss) paragraph (2)(b) are not fulfilled (i.e. she has not suffered a mental condition requiring medical treatment).

Damage and accountability. The Article produces an appreciable proximity between legally relevant damage and the basis for accountability. This lies in the nature of the beast and is therefore unavoidable. However, one must still distinguish between these two aspects. This is evident in all cases in which a claim is brought against an employer on the ground that an employee has fraudulently deceived the injured person (see VI.–3:201 (Accountability for damage caused by employees and representatives)). The distinction between legally relevant damage and the basis of accountability of course also remains important where the person causing the damage and the person sued are the same person. This is because the person causing the deception need not have acted with intention as regards causing the loss of the deceived party. While under the conditions of this Article this may indeed very rarely not be the case, deviating case structures are certainly conceivable.

Illustration 3

A bank (B) makes a credit guarantee to one of its customers (X) dependant on proof that goods sold have also actually been delivered to X's buyers. Upon X's request, one of his buyers, Y, accordingly signs a receipt, although Y knows that the goods have not yet been delivered. Y merely wishes to speed up the process of B's obtaining credit, having no cause to suppose that X could be in financial difficulty, nor thus that it was not an everyday transaction with B which was at stake. B's claim against X for the repayment of the loan proves worthless. Y has caused B's loss negligently, even though Y fraudulently deceived B and thereby caused B's loss. Causing the loss negligently suffices for liability (VI.–1:101 (Basic rule) in conjunction with VI.–3:102 (Negligence)).

B. Fraudulent misrepresentation

Misrepresentation. The Article relates to causing loss through misrepresentation. The formulation takes its cue from II.–7:205 (Fraud) which, however, speaks of fraudulent 'representation'. Both texts consciously avoid technical concepts of particular national legal systems, especially those of criminal law (e.g. *Betrug* or 'obtaining something by deception'). The misrepresentation, moreover, can take place in any conceivable manner, thus "by words or conduct". As regards the latter aspect, a fraudulent misrepresentation through omission is conceivable where a duty to provide information exists.

Illustration 4

A does not inform B before they enter into marriage that he is impotent. B is entitled to claim against B for reparation of non-economic loss suffered. The family law repercussions (divorce, post-marital maintenance) do not conflict with the award of reparation.

'Fraudulent' misrepresentation. According to VI.–2:210(2) a misrepresentation is "fraudulent" under two (cumulative) conditions: (i) it must be made with knowledge or belief that the representation is false, and (ii) it must be intended to induce the recipient to make a mistake. With the formulation "made with belief that the representation is false" those cases are addressed in which the person making the representation was not sure that the information was false but made it in the hope and assumption that it was false. If the information was in

actual fact true, what we have is merely an attempt, irrelevant for private law; there is then no ‘misrepresentation’ within the meaning of section (1).

Intention to induce the recipient to make a mistake. The second element of a fraudulent misrepresentation lies in the intention to induce the recipient to make a mistake; furthermore, the latter must actually make a mistake, since otherwise the misrepresentation cannot have been causative of the loss. The term “intention”, so far as it relates to the causation of the loss, is defined in VI.–3:101 (Intention). In VI.–2:210(2) it is the intention to induce a mistake which is in issue. It is not every ill-considered statement capable of inducing error which justifies liability. What is required in this context is rather that the deceiver’s mind is directed towards the causation of the victim’s error. The aim of the misrepresentation must be to induce an error; it is not sufficient that the person making the misrepresentation merely willingly reckons with an error on the part of the deceived person.

Illustration 5

B, a board member of a company intentionally falsely informs a broker that after exploratory drilling the company has not found any oil reserves. In doing so B wanted to protect the interests of the company. He was not, however, concerned with inducing the shareholders to infer that their shares were likely to become worthless and therefore should be sold as soon as possible. B did not fraudulently deceive the shareholders.

VI.–2:211: Loss upon inducement of non-performance of obligation

Without prejudice to the other provisions of this Section, loss caused to a person as a result of another’s inducement of the non-performance of an obligation by a third person is legally relevant damage only if:

- (a) the obligation was owed to the person sustaining the loss; and*
- (b) the person inducing the non-performance:*
 - (i) intended the third person to fail to perform the obligation; and*
 - (ii) did not act in legitimate protection of the inducing person’s own interest.*

COMMENTS

A. The Article in overview

Inducing non-performance of an obligation. Inducing non-performance of a contractual obligation gives rise to non-contractual liability in all parts of the European Union. In classical Roman law this was one of the recognised groups of cases of the *actio de dolo*, which even today – often as “intentional causation of damage contrary to good morals” – still features in many civil codes. Where this specific basis of claim is missing, inducing non-performance of a contractual obligation is either subsumed within the basic non-contractual liability law norms or (as in the Common Law) constitutes an independent basis of non-contractual liability in itself.

Intention required. Inducing non-performance of a contractual or other obligation necessarily requires intention. Legally relevant damage is not caused by a third party to the contract when that third party merely exploits the conduct of another party in non-performance of a contractual obligation or causes it through negligence. This Article therefore has a direct intrinsic connection with VI.–2:101 (Meaning of legally relevant damage)

paragraph (1)(b) and (c). These provisions give expression to the general (and essentially self-evident) rule that “relative” rights can in principle only be infringed by persons who owe a corresponding obligation to the holder of the right to render the relevant performance. Were this not so, the right would cease to be “relative” in character. However, if a person is intentionally induced not to perform contractual or other obligations to a third party, the third party who thereby suffers loss may claim reparation from the person inducing the non-performance.

Illustration 1

A and B conclude a contract for the production of a film. A assists with approximately 25% of the production costs and in return is to get a share of the expected net profit. A considerable part of the remaining costs are financed by B on credit, including a loan from company X. In order to secure its loan and despite knowledge of the agreements (under partnership law) between A and B, X has all of B’s rights over the subsequent film distribution assigned to it. X induced B to breach the contract with A.

Illustration 2

The organiser of an opera production (A) persuades a famous female opera singer (S) not to honour her contract with a competing opera production B and instead to sing with A. A is liable to B to compensate for the damage this causes. A would not be liable to B, however, if A had merely brought S on a ski trip, during which she broke her leg and was unable to perform for B; that remains so even if A had known that the contract with B forbade S from such recreational activities during the period of her contractual engagement to B.

Damage and accountability. The relationship between legally relevant damage and accountability in this Article is no different from how it is under VI.–2:210 (Loss upon fraudulent misrepresentation). Thus, an intentional inducement of the non-performance of a contractual obligation or other obligation is all that is involved (VI.–2:211(b)(i)). In contrast, it is not necessary that the loss resulting from it was also intended or was at least willingly reckoned with (VI.–1:101 (Basic rule) paragraph (2)). However, in the context of the present Article the two aspects can for the most part scarcely be separated from one another. This is because any person who induces another to fail to perform an obligation also invariably does so conscious of the fact that this harms the creditor. It remains to be considered in the context of this Article that an employer can be liable for an employee’s inducement of a non-performance of an obligation .

Loss. As in VI.–2:210 (Loss upon fraudulent misrepresentation), “pure economic losses” are what are mostly in issue in this Article, but it is not limited to such losses. Non-economic losses are also recoverable. For harm of other kinds, overlap with previous provisions of this Chapter will also occur, e.g. where the supplier of a service is bribed to damage the item to be repaired. VI.–2:208 (Loss upon unlawful impairment of business) stretches beyond the scope of the present Article. This is because undertakings which are in a competitive relationship with one another may be subject to more stringent obligations under competition law to respect others’ contractual relationships than is the case under the general rule in this Article .

The entitled claimant. According to sub-paragraph (a) only the person whose entitlement (within the law of obligations) is interfered with suffers a legally relevant damage. The person who is induced not to perform the obligation, by contrast, is expected to withstand temptation and, on failing to do so, to must suffer the consequences of the non-performance (vis-à-vis the

creditor). That person will not be able to invoke this Article to pass the burden of any resultant liability to pay damages for non-performance of the obligation to the person inducing the non-performance. Nor is there any solidary liability, in relation to the third party, between the person inducing the non-performance of the obligation and the non-performing party (which would in effect provide the inducing person with a right of recourse vis-à-vis the non-performer). In cases in which the person who is to be induced is subjected to physical or mental pressure, that person has a preventative recourse on the basis of VI.-1:102 (Prevention) in conjunction with VI.-2:101 (Meaning of legally relevant damage).

Illustration 3

X, formerly a member of a religiously active sect (S), has since become an employee in an ecclesiastical undertaking. The contract of employment prohibits X from membership in associations of a type like S. Nevertheless, S threatens X with considerable disadvantages if he does not pay his membership fees to the sect and serve its interests. Membership in the community is for life, the sect insists. X has a claim against S for prevention of the pressure.

B. Non-performance of obligation

Contractual and other obligations. The Article is not restricted to inducing non-performance of a contractual obligation. In practice that may be the most important type of case, but there is no reason in principle why contractual rights should be treated differently from rights to the performance of other obligations. Hence this provision embraces claims in respect of non-contractual obligations, including alimentary obligations. Moreover, where the obligation arises out of a contract, the fact that the contract may be avoided does not prevent a right to reparation under non-contractual liability law.

Illustration 4

M, operator of a hamburger restaurant, wishes to enlarge the business and to cease using the premises hitherto used in favour of larger restaurant premises in direct proximity. He enters into negotiations with company P, surrendering to P his former premises because P assures him that it will operate an art gallery there, thus not intending to compete with M. In reality, at the time of the negotiations, X had attained a decisive influence over P (through an acquisition of shares effected in secrecy). X instructs P, as planned from the beginning, to open a hamburger restaurant in M's former premises. Shortly afterwards, P gets into financial difficulties. Although M can avoid the contract with P due to fraudulent misrepresentation, M also has a claim to reparation directly against X, who induced P to breach its agreement with M.

Obligation 'owed to the person sustaining the loss'. As already noted, the obligation in question must always be owed to the injured person by the party induced to fail to perform (sub-paragraph (a)). It does not suffice that the obligation is owed to another person. Conversely, the Article does not require that the identity of the injured creditor was known to the deceiver.

Breach of conjugal obligations. According to its wording, interferences in another's marriage, and in particular the inducement to commit adultery also fall under this provision. In this context, however, regard must be had to VI.-1:103 (Scope of application) sub-paragraph (c), and thus the question is raised whether the applicable law on marriage strives to regulate such cases conclusively. That would usually be the case in the matter of adultery:

cf. above: illustration 5 under VI.–1:103. If the adulterous spouse does not become liable under non-contractual liability law, the third party who commits adultery with him or her cannot be held liable either. Otherwise the third party could have recourse against the spouse as a joint injuring person in their internal relationship as joint debtors and thereby circumvent the conclusiveness of the rule provided for by family law.

Non-performance. Legally relevant damage is only ever present where the respective loss is the consequence of a non-performance of an obligation on the part of the claimant’s debtor. Thus, if e.g. an employee is poached from an employer due to the poacher’s offering the employee a higher salary, then as long as the latter terminates the existing employment relationship and changes employment, inducement to non-performance of a contractual obligation is not in issue. The situation is the same if a competitor approaches the customer of another undertaking with the purpose of doing business with the customer in the future. Where unfair means are used in these and other types of cases, it may be a case concerning VI.–2:208 (Loss upon unlawful impairment of business). Typical situations for VI.–2:211 by contrast consist of the inducement to breach a prohibition against competition contained in the contract between the party induced to breach and the injured third party and inducements to terminate contractual relationships unlawfully.

Illustration 5

During the owners’ general meeting, certain apartment owners of a multi-storey building instigate the dismissal of the building’s supposedly inefficient caretaker, using false facts as a pretext, after having accepted payment from the prospective replacement caretaker as remuneration for “being instrumental” in procuring the new job. The caretaker who is dismissed suffers legally relevant damage under VI.–2:204 (Loss upon communication of incorrect information about another), as well as under VI.–2:208 (Loss upon unlawful impairment of business) and the present Article.

C. Intentional inducement

Intentional inducement. According to paragraph (i) the person inducing the non-performance must have “intended” the third person to fail to perform the obligation. As in VI.–2:210 (Loss upon fraudulent misrepresentation), the requirement of “intention” is thus related not to loss, but to the failure to perform. The concept of “intention” is therefore once again not identical with that of VI.–3:101 (Intention), which is linked to the causation of the damage. What is required in the context of the present Article is rather that the inducing person’s mind is directed towards the non-performance. The non-performance itself must be intended; it does not suffice that the inducing person acting merely willingly reckoned with it as a side-effect or exploited a non-performance which had already occurred. Only in the case of acts of infringement to the detriment of competitors may this be different, as noted above, due to the application of standards of competition law. That case is within the scope of application of VI.–2:208 (Loss upon unlawful impairment of business).

Absence of legitimate interest. Legally relevant damage within the meaning of the Article is also absent under sub-paragraph (b)(ii), if the inducing person acted “in legitimate protection” of the inducing person’s own interest. A person is not bound to allow a fortuitous legal opportunity to go to waste, solely because by grasping it detriment would be caused to a third party.

Illustration 6

Before her death, an old lady (L) gives away the same piece of land to two different donees consecutively. The second donee (X) effects a registration in the land registry and in this way acquires ownership under the applicable land law because the prior donee (Y) did not carry out registration. At the time the conclusion of the contract of donation was offered to her by L, X did not know anything of the contract with Y, but X found out about it before the registration in the land registry was effected. X merely pursued her legitimate interests. She did not induce L to breach her contract with Y; consequently, X has no non-contractual liability to Y.

CHAPTER 3: ACCOUNTABILITY

Section 1: Intention and negligence

VI.-3:101: Intention

A person causes legally relevant damage intentionally when that person causes such damage either:

(a) meaning to cause damage of the type caused; or

(b) by conduct which that person means to do, knowing that such damage, or damage of that type, will or will almost certainly be caused.

COMMENTS

A. General

Intention as ground of accountability. Intention, like negligence, is a ground of accountability (VI.-1:101 (Basic rule)). What is to be understood by the notions of intention and negligence is defined in this Section. Liability arising from intentional acts and liability arising from negligence follow in part different rules: see e.g. VI.-2:101(3) (Meaning of legally relevant damage), VI.-5:103 (Damage caused by a criminal to a collaborator) and VI.-5:401 (Contractual exclusions and limitation of liability). Moreover, the differentiation plays a role in the rule on reduction of claims due to contributory fault: see VI.-5:102 (Contributory fault and accountability). The question whether the causation of damage occurred intentionally or negligently can also be crucial, however, in other contexts – for example, within the field of causation.

Illustration 1

A ten year old child drops a stone from a bridge over a motorway and as a result cause the death of a passenger in a bus. The passenger's surviving dependents make a claim against, among others, the undertaking responsible for the motorway on the basis (well-founded in the circumstances) that it has failed to adopt the required safety measures and has thus acted negligently. The causal connection between that negligence and the damage is only broken if the child brought about the death of the passenger intentionally. Assuming the child was not focused on killing another (VI.-

3:101(a)), the matter turns on whether, according to the child's individual's stage of development, the child knew that with the greatest probability a death would result from the action of dropping the stone. In the case of a ten year old, that will be answered in the negative if there any is doubt on the issue.

Natural and legal persons. The provisions of this Section are not restricted to natural persons; the general rule of interpretation applies whereby "person" is to be understood as including legal as well as natural persons (see Annex 1). Legal persons are as capable of causing damage intentionally (or negligently, as the case may be) as natural persons. The intention of the legal person is found by establishing the state of mind of natural persons acting as its governing organ (see VI.-1:103 (Scope of application) sub-paragraph (b) and comments on that Article).

B. Intention

The need for a definition. The Article effects a definition of the concept of intention in relation to the causing of damage. Such a definition is indispensable for various reasons. In the first place, European private law currently lacks a uniform definition of intention. Secondly, under these rules, the presence (or absence) of intention can play a role in a not insignificant number of cases. Thirdly, liability for intentionally causing damage is, as a rule, not insurable. For that reason such liability affects the liable person in a direct and potentially ruinous way. The inclination of private law therefore ought to be towards invoking a somewhat narrow concept of intention.

Intention to do the act required but not sufficient. The Article does not adopt the notion of 'intention' invoked in the English law of trespass where a mere intention to do the act suffices, it being established that the act interferes with another's rights. A person only acts intentionally in the sense of this Article if that person (i) acts as he or she meant to act, and (ii) either means to cause legally relevant damage (sub-paragraph (a)) or recognises that it is as good as certain that such damage will be the consequence of the conduct and nonetheless does not desist from that conduct (sub-paragraph (b)). The reference point for intention for present purposes is thus always the causation of a *legally relevant* damage.

Illustration 2

A damages or destroys the property of another, believing that it belongs to him. A acts negligently if he ought reasonably to have known that it was not his property, but there is no intentional causation of legally relevant damage. That is because the destruction of one's own property does not constitute a legally relevant damage.

On the other hand, a person does not act intentionally if the person does not know what he or she is doing (e.g. a patient at a hospital who unconsciously hits out in sleep or under the influence of medication), or, while so aware, is unable to act differently (e.g. because of duress or because a sudden impairment of certain cerebral functions temporarily deprives that person of the ability to control the conduct).

C. Sub-paragraph (a)

Deliberate causation of legally relevant damage. A person acts intentionally when the causation of the legally relevant damage is deliberate. The concept of legally relevant damage is established by Chapter 2. The liable person therefore must know the elements of the applicable concept of damage and have intended to bring these about. It is not essential, of course, that the person acting recognises that the damage about to be caused would be characterised in law as "legally relevant". On the other hand, the person must be conscious of doing wrong; in other words, the lay person must anticipate that civil legal consequences are to be reckoned with. Where the person acting has made a mistake about the circumstances or

the wrongful nature of the conduct, the ground of accountability (if any) will be negligence rather than intention.

Breach of a statutory rule of behaviour. Equally, a person who deliberately and knowingly infringes a given statutory rule of behaviour (e.g. by driving faster than traffic regulations permit), but who in no way means to cause an accident by doing so, will not act intentionally.

Omissions. The same applies to cases of omission. Someone who is obliged to intervene and who is also aware of that, but does nothing to avert the impending damage, only acts intentionally if he or she remains inactive precisely in order that the damage may occur. Intention always relates to the incidence of damage, and the infringement of a norm of behaviour does not constitute per se a damage (only per se negligence). Where a woman who knows she is obliged in the morning to clear the snow and black ice from the pavement in front of her house, resolves nonetheless to stay in bed, and a neighbour slips and suffers a leg fracture, the neighbour's injury is caused negligently and not intentionally.

Illustration 3

By contrast, a drunken car driver, who suddenly steers his vehicle towards two pedestrians in order to terrify them and in doing so runs them over, causes death intentionally by an omission if, although he knows that one of them is particularly badly injured and is unlikely to be helped by a third party at that time of night, simply drives on, leaving the pedestrian to bleed to death.

Causation. On the other hand, those who witness a situation in which they are not obliged to intervene and do not intervene, although capable of doing so, because they take delight in the impending damage, act intentionally, but they do not cause legally relevant damage intentionally.

Illustration 4

A sees that in the house belonging to her neighbour, whom she has always hated, a fire has started to burn. She does not inform the fire service because she hopes that the whole building will be destroyed. A *acts* intentionally, but she has not *caused* the loss of the house. A would only have caused the damage by her omission to act if she had been under a duty towards her neighbour (and not only to the public at large) to intervene.

“Damage of the type caused”. To establish intention it is sufficient that the person meant to cause damage of the type in fact brought about. If the person is mistaken about circumstances which are immaterial for the qualification of a damage as legally relevant, the conduct remains governed by the regime for liability for intentional causation of damage.

Illustration 5

A intends to damage B's car and vandalises a car which formerly belonged to B. A did not know that B had recently transferred the car to C. The property damage suffered by C was caused intentionally. A knew that he was causing damage to the property of another and meant to do so. The situation is the same in the textbook case where A means to shoot B, but in the darkness shoots C by mistake.

D. Sub-paragraph (b)

General. Sub-paragraph (b) concerns cases on the border between intention and negligence. A person causes legally relevant damage intentionally (and not merely negligently) when that person acts as he or she means to act and at the same time knows that in doing so he or she will cause legally relevant damage. The present Article (in conformity with these rules generally) does not adopt the formulation of PECL Art. 1:301 under which “[a]n ‘intentional’

act includes an act done recklessly”. Nor does the Article use the concept of “recklessness” (defined in Annex 1 as follows – “[a] person is “reckless” if the person knows of an obvious and serious risk of proceeding in a certain way but nonetheless voluntarily proceeds without caring whether or not the risk materialises”). That concept is helpful for the purposes of contract law (see, e.g., III.–3:501 (Scope and definition) and III.–3:703 (Foreseeability)), but not for those of the law on non-contractual liability for damage. It was important for the latter that a simple structure of grounds of accountability be maintained and thus merely to distinguish between intention and negligence and not between intention, negligence and recklessness. However, first and foremost the decisive question for the purposes of non-contractual liability should not be whether a person ‘could not care less’ whether or not the damage concerned will result from conduct, but rather whether the person knows that the damage will be a well-nigh certain consequence of the conduct. A person who hopes desperately that damage will not result, but who knows that the hope is completely unrealistic in the circumstances, brings about that damage intentionally.

Illustration 6

A drives at high speed in the outside lane round a blind bend in the road. Houses by the side of the road hide the headlights of an oncoming car. A head-on collision results. The damage is not caused intentionally. Had A, however, seen the oncoming car before he began to overtake and it was evident to him that an accident was highly probable and unavoidable if he did not pull back into the inside lane, the damage caused by carrying on in the outside lane is intentional. Intention in such a case is not excluded simply because the person acting hoped at the time that ‘everything would turn out all right’.

Dolus eventualis. Sub-paragraph therefore equates extensively, but not perfectly, to the traditional notion of *dolus eventualis* which in some legal systems is defined exactly as Annex 1 defines “recklessness”. However, sub-paragraph (b) excludes conscious carelessness from the notion of intention. Furthermore, a person does not act intentionally when causing damage simply through gross negligence, whether or not that person is aware of the carelessness.

Illustration 7

A construction company which undertakes excavation work on another’s land and is aware of a cable laid there causes damage intentionally, when it slices the cable, if it made no inquiries as to the position of the cable and knew that, in view of the size of the machine being deployed and the small size of the plot of land, it was well-nigh impossible that the machine would miss the cable. On the other hand, a person who negligently fails even to contemplate that there might be cables laid beneath the soil acts merely negligently.

Gross negligence. Gross negligence is an unreasonable or extraordinary want of care (see Annex 1 – “There is ‘gross negligence’ if a person is guilty of a profound failure to take such care as is self-evidently required in the circumstances”) and therefore does not amount to intention. See also VI.–5:102(2)(c) (Contributory fault and accountability).

“by conduct which that person means to do...”. A person causes legally relevant damage intentionally only when he or she meant to act in the way in which he or she has in fact acted. This excludes from the notion of intention, therefore, not just acts under duress, but also unintended incorrect responses. A guest whose lit cigar falls from his hand and damages the carpet in his host’s flat does not cause that damage intentionally. While he means to smoke, he does not mean to drop the cigar.

“... knowing that ... damage ... will almost certainly be caused”. Crucial for the demarcation between intention and negligence is, however, the question of whether the person

acting knew that legally relevant damage would be caused by the conduct. The assured knowledge that such damage will arise is placed by sub-paragraph (b) on the same footing as cases in which the person acting knew that legally relevant damage would “almost certainly” be caused. This gives the judge a certain amount of discretion in order to do justice in the circumstances of each individual case. Where the abnormally high likelihood of damage occurring would be obvious to everyone and there are no special circumstances present which would justify the inference that the person in question was not aware of this well-nigh certain likelihood, then this suffices for the inference of intentional harm, even in the case of an omission. Once again, it is not necessary that the perpetrator should have foreseen the exact causal chain of events and the concrete damage arising. The foresight need only have related to damage of this type.

Illustration 8

A as owner carries the responsibility for a dilapidated old building. It is empty and ought to be torn down to make way for a new one. Children are in shorts playing soccer in the building. A watches this and is aware that in light of the countless glass shards lying around, it is impossible that this will “end well” if he does not intervene immediately. Nonetheless he does nothing about it. Assuming that A is obliged to undertake preventative measures in respect of the dangers facing the children and supposing also that A is conscious of this obligation, A will have acted intentionally in relation to the later injuries to the children even though his main reason for doing nothing might have been to save money.

Illustration 9

A person who fires at a jeep from a distance of a few short metres and knows that the passengers of the car may be killed by the shots, kills intentionally even where the primary motive was to injure the victim in order to satiate a need for revenge.

VI.-3:102: Negligence

A person causes legally relevant damage negligently when that person causes the damage by conduct which either:

- (a) does not meet the particular standard of care provided by a statutory provision whose purpose is the protection of the injured person from the damage suffered; or***
- (b) does not otherwise amount to such care as could be expected from a reasonably careful person in the circumstances of the case.***

COMMENTS

A. General

Scope. This Article defines negligence as a ground of accountability for the purposes of the present Book. It is not a question of creating a self-standing “tort of negligence” but rather (as has been done for intention in the preceding Article) of filling out the corresponding reference in VI.-1:101 (Basic rule)The present Article is only concerned with negligent or careless conduct. Consequently it does not address cases in which liability is derived from infringement of a statutory duty which does not revolve around a requirement to exercise care. Where liability is exclusively based on the fact that the level of safety demanded by statute has not been achieved (as may be the case, for example, in respect of certain statutes concerned with accidents at work), one has left the realm of negligence and is concerned instead with a specific form of liability without (intention or) negligence, see VI.-3:207 (Other accountability for the causation of legally relevant damage).

“by conduct”. Negligence requires conduct controlled by will. An unconscious act, for instance movement while asleep, under narcosis or under the influence of a sudden apoplectic seizure, is not “conduct” within the meaning of VI.–3:101 (Intention) or the present Article. The same goes for an omission in a situation in which the affected party could not have recognised or removed the danger even when exercising all due care.

Illustration 1

On a foggy winter evening a boat capsizes on a lake. The boat occupant calls for help but the fog swallows up his calls. It cannot be said of a woman walking along the shore - who does not hear the calls and therefore does not act - that she “omitted” to undertake a rescue effort; in fact there was no “conduct” at all on her part in relation to the person drowning.

Illustration 2

However, the situation is different where an old man who is hard of hearing is shovelling snow from the pavement and without hearing the warning cry of a passer-by approaching him from behind, hits her across the face with the shovel. His bad hearing does not alter the fact that the motion with the shovel was conduct relevant to the danger and controlled by will. Due to the fact that the man was aware of his bad hearing, he even acted negligently: he should have been aware of the danger and should have looked behind him before swinging the shovel..

Sources of duties of careful conduct. This rule mirrors the two sources which in every Member State generate the duties of careful conduct in relation to the interests of another protected by the law on non-contractual liability for damage: statutory provisions (sub-paragraph (a)) and the general precept of not harming another (*neminem laedere*, sub-paragraph (b)). A general duty of care is implied here. Previous generations formulated it by referring to the conduct expected of a *bonus paterfamilias* or *reasonable man*.

Positive acts and omissions. The Article relates – in both alternatives – as much to omissions as it does to positive acts. This follows from the use of the word “conduct” (see Annex 1 – conduct includes “not doing something”). A person who omits doing something acts negligently if he or she either does not take the preventive measures that must be taken in the interests of the injured person under statutory provisions or where he or she does not do something that a reasonably careful person in the circumstances of the case would have done in favour of the injured person. It is not possible to draw a clearly-defined line between positive acts and omissions. The draft therefore deals with both forms of conduct in principally the same fashion.

Persons under eighteen. In relation to the requirements of due care to be placed on youths and children under sub-paragraph (b) of the Article, special rules are to be found in VI.–3:103 (Persons under eighteen) paragraph (1). While children who have not yet attained their seventh year may indeed likewise be capable of acting negligently, the consequences of such action will not be imputed to them under VI.–3:103(2).

Mentally handicapped persons. In cases concerning mentally disabled persons, who cannot distinguish between right and wrong as a result of their disability, there is a different course of action from the start. Such persons may also readily deviate from the standard of care, which according to VI.–3:201 (Accountability for damage caused by children or supervised persons) is to be observed in principle by everyone. The only requirement is that it is “conduct” controlled by will. Under the circumstances in VI.–5:301 (Mental incompetence), for which

the party claimed against bears the burden of proof, a mental disability is a defence that, depending on the circumstances of the case, can lead to a reduction or exclusion of liability. The rule relates mainly to mentally disabled adults, but can also be of benefit to mentally disabled adolescents, who fall short of the behavioural standard for their age group. Of course, the relief from liability only embraces cases where intention or negligence is the source of accountability, not another possible parallel basis of responsibility under the factual situations set out in the second Section of the third Chapter of these basic rules.

Illustration 3

While sitting at the steering wheel, X suddenly and unforeseeably suffers a brain haemorrhage. While he does remain conscious and realises that he is steering the car into the middle of a lane of traffic, he is no longer capable of doing anything to stop this due to the brain haemorrhage. X acts negligently within the meaning of VI.–3:102. He is also not entitled to any defence under VI.–5:301 (Mental incompetence), since he fully recognises that he is acting improperly. Conversely, had X been rendered unconscious, under VI.–3:205 (Accountability for damage caused by motor vehicles) he would only be liable for the subsequent accident if he was not merely the driver, but also the owner of the vehicle.

Physically disabled persons. Physically disabled persons are subject to the same requirements of due care as physically able persons, to the extent that they are aware of their physical disability, and their conduct must be adjusted accordingly, see Illustration 2 above. A person who must anticipate sudden but short-lived losses of vision due to a chronic circulatory disorder is not permitted to sit at the wheel of a car.

B. Duties of care required by statute (sub-paragraph (a))

Statutory provisions. A person acts negligently where the person does not behave as is prescribed by statute for the situation which has arisen, in so far as a danger is realised thereby, the prevention of which is the aim of the law in the interests of the injured person. What a “statute” is within the meaning of VI.–3:102 is not expressly stated by these rules. To this extent, with VI.–7:102 (Statutory provisions), they refer to the term “statute” as used in the respective applicable law. However, it is to be emphasised that it not only concerns primary legislation, but also subordinate legislation effected by governmental agency (regulations, etc.) and local bye-laws (e.g. on the cleaning of footpaths). On the other hand, guidelines issued by social insurance bodies for the prevention of accidents are, as a rule, not “statutory” provisions.

Criminal law provisions. If the statute is part of the criminal law, it is sufficient that the liable person objectively has failed to behave in the manner required by the statutory norm. It is not necessary that the person can also in fact be punished for an offence. It may well be, for example, that in that particular jurisdiction criminal responsibility commences only at the age of 16 or that criminal prosecution depends on circumstances that have nothing to do with the reparation of damage in civil law.

Simple references to the duty to act with reasonable care. From the perspective of the law on negligence one must differentiate four types of statutory provision. There are, first, statutory provisions which merely involve a general requirement to take care not to violate the physical integrity, rights or interests of another. Provisions of this type are irrelevant for the purposes of sub-paragraph (a) because they do not say more than is already to be found in sub-paragraph (b). In other words, statutory provisions of this type set down no “particular”

standard of care. For instance, provisions that state no more than that “negligent bodily injury” is criminally punishable belong to this group.

Provisions reducing the standard of care. Secondly, there are provisions whose effect is that in defined situations or for defined persons (e.g. parents and children or spouses in their relation to each other) compliance with a *lower* standard of care than the general one suffices. Such provisions prescribe liability for damage caused only typically in the case of gross negligence (and of course in the case of intention). They take priority over the general requirement of care by constituting special regimes. That is taken care of in VI.–1:103 (Scope of application) sub-paragraph (c). To the extent that employees are also personally liable *vis à vis* third parties under the applicable law only in the case of grave fault, in particular only where they are charged with gross negligence, VI.–7:104 (Liability of employees, employers, trade unions and employers’ associations) is then to be taken into account.

Provisions requiring a higher standard of care. A third class of statutory provisions is those which require from persons undertaking defined activities compliance with a *higher* standard of care than the general standard. In that case the failure to reach the stipulated higher standard amounts to negligence. Of course, such provisions must have the establishment of duties of care as their subject-matter; they may not merely impose on their addressees an obligation to ensure that a particular state of affairs (a particular outcome) occurs. This is because provisions of the latter type do not refer to the notion of care at all. They are therefore, as mentioned earlier, excluded from this Article and dealt with in VI.–3:207 (Other accountability for the causation of legally relevant damage). One thinks, for example, of provisions relating to safety equipment for machines which are operated by workers. It is indeed correct that the borderline between the protective laws embraced by sub-paragraph (a) of the present Article and by VI.–3:207 (Other accountability for the causation of legally relevant damage) is theoretically and practically not always easily drawn. This is because conceivably there are statutory rules capable of being subsumed under both provisions. For instance, a statutory rule might prescribe that for certain operations a second heart-lung machine must be available in the operating theatre. Such duties of conduct have a double function because they indeed specify a special standard of care in relation to the protected interest, and simultaneously call for a certain state. As a result, in such a case the injured person can invoke two grounds of accountability. However, this does not greatly affect the practical result. This is down to the fact that VI.–5:302 (Event beyond control) also applies to VI.–3:207 (Other accountability for the causation of legally relevant damage).

Provisions particularising the general duty of care. Fourthly, a number of statutory provisions have as their function a particularisation or concretisation of the general duty of care for a defined situation. They stand at the focus of the rule in VI.–3:102. Typical examples are provided by provisions of building and planning law and of commercial law, by rules on earning a livelihood, by provisions on health protection and by the rules in road traffic regulations.

Adherence to the provision does not automatically relieve liability in negligence. Provisions of this type, however, are not a *carte blanche* for acting negligently in a given case. Where the average person under the circumstances must recognise that adherence to a specific statutory safety requirement is insufficient in a given situation and where statute leaves a corresponding discretion to act, then a person in that situation must use the discretion as a reasonably careful person in the circumstances of the case would have done.

Illustration 4

A regulation on the protection of woods requires farmers burning stubble in their fields in autumn to observe a minimum distance of 300 metres from the nearest wood when igniting the stubble. B complies with that requirement. However, on the day in question an exceptionally strong wind prevails and B ought to have appreciated that the minimum distance laid down in the statute would not suffice under these weather conditions. The wood catches fire. B has acted negligently according to sub-paragraph (b). Compliance with the statutory provision does not relieve B from the need to comply with the general standard of care.

Illustration 5

Things are of course different where statute practically prohibits taking reliable safety measures. For instance, one thinks of provisions for the protection of buildings of historic importance and natural monuments, like for example a medieval tree of justice, which may not be felled although this would be the only available safety measure for the protection of passers-by.

Prohibitory norms and norms of care. Where statute merely mentions a prohibition, but does not articulate any specific duties of care, then the issue of negligence is judged according to the rule in sub-paragraph (b), which of course does not rule out considering the values of the prohibitory norm in the context of the general norm of care.

Illustration 6

A road traffic sign which indicates a one-way street and accordingly prohibits entry into the street from the exit is masked by a parked lorry. As A does not know this area and there are no other indications by which she might recognise that the road is a one-way street (as would be the case if there were indicative road markings or the cars on her side of the road were all parked against her direction of passage), she does not act negligently if she turns into the road and an accident results. That does not exclude the argument, however, that the level of care required in recognising traffic signs will be rather high.

The purpose of the statute. The purpose of the statutory norm of care infringed must be to safeguard the injured person from the legally relevant damage, which he has actually suffered. Hence the purpose of the statute must not simply be either the assurance of protection in general or predominantly of the public interest, or the protection of the injured person from a damage other than the one which has in fact occurred.

Illustration 7

A, B and C are witnesses to an accident in which X is badly injured. It would have been an easy matter for them to render first aid to X and to alert the emergency services. They neglect to do that. A, B and C are not liable under these rules if, even though breach of that duty to render first aid at the place where the accident has taken place constitutes a crime, the duty to render assistance existed solely for reasons of public interest. This is the practice in most Member States.

Illustration 8

There exists a statutory obligation to keep animals transported on the deck of a ship caged up. The purpose of this statute is to prevent the transmission of disease amongst

animals. Its purpose is not to prevent the animals from falling overboard, though it has that collateral effect. In regard to the statutory provision at least, therefore, there is consequently no negligence when a failure to cage animals leads to their loss when they fall overboard. That of course does not exclude the possibility of recognising, aside from the statute, a breach of the general duty of care under sub-paragraph (b).

C. The general duty of care (sub-paragraph (b))

An objective standard. Sub-paragraph (b) deals with the second form of negligence. Conduct is negligent when it does not satisfy the care which must be exercised under the circumstances of the case by a reasonably prudent person. The standard is an objective one. It does not turn on the individual abilities of the person acting, rather it is based on what can be reasonably expected of that person: a dentist cannot escape liability by claiming to be a slow learner and very forgetful. Persons commencing their professional lives must likewise live up to the standard of the competent professional (and likewise the newly qualified driver must reach the standard of the more experienced), although it would be wrong to measure them by the standard of the most capable.

Conclusive list of deciding factors impossible. The question of what reasonably careful conduct means under the circumstances of each individual case is affected by several factors which are beyond conclusive enumeration. On the one hand, “internally” maintaining concentration is necessary because this facilitates the awareness of danger. Whoever turns a blind eye to the foreseeable negative consequences of actions can only be saved by sheer luck from harming others.

Illustration 9

Where a construction company lays underground drinking water pipelines, it must not only obtain the plans from the relevant telephone company on the exact location of their cables, in fact it must also check whether the site plan specifications are in conformity with actual proportions.

What is to be arranged or done in the “external” world does not ultimately hinge on a weighing up of the costs and benefits of prevention. The type and extent of the imminent damage serve to dictate the type and extent of the measures necessary for its prevention. In some cases information to the public or a simple indication of a particular source of danger will be sufficient, in others the source of danger itself must be confronted. Also relevant is whether there was a particular close relationship or a relationship of trust between the person acting and the injured party, since fiduciary duties and similar factors can raise the degree of necessary care. Other relevant factors may be whether risks of private or commercial life are involved, whether children or only adults are to be anticipated as being in proximity to the source of danger, whether the relevant risk was known or arose for the first time etc. The conceivable situations are unlimited. The assessment of negligence in particular cases must therefore remain with the courts, whose assessment of what constitutes careful conduct or conduct without due care in a given set of facts may quite properly change over time. Generally it is of course to be borne in mind that the requirements of necessary care may not be arbitrarily raised. This would not only flatten the differentiation with so-called “strict” liability, but also emphatically hinder human activity; people would scarcely be able to move freely, constantly in fear of possibly encountering liability.

Illustration 10

During the warm-up before a volleyball game a ball is inadvertently hit high into the tiers of spectators, where it hits a visitor so hard in the eye that she is blinded. The distance and arrangement of the spectator area by the club was in conformity with the

structural safety measures; neither the player nor the organising club ought to have anticipated such an incident. No negligent physical injury exists.

Organisational defects. A particular form of negligence is seen in so-called defective organisation. It is not only the specific safety risks associated with events with mass attendance which are involved here. In fact what is involved is also and in particular the duty on all large organisations to arrange their working operations in such a way that third parties are not endangered by internal problems with communication, the hierarchy of authority or decision-making. In practice legal persons in particular bear the burden of such organisational duties. They are subject to them independent of the organisational duties to which the natural persons acting on their behalf are subject.

VI.–3:103: Persons under eighteen

(1) A person under eighteen years of age is accountable for causing legally relevant damage according to VI.–3:102 (Negligence) sub-paragraph (b) only in so far as that person does not exercise such care as could be expected from a reasonably careful person of the same age in the circumstances of the case.

(2) A person under seven years of age is not accountable for causing damage intentionally or negligently.

(3) However, paragraphs (1) and (2) do not apply to the extent that:

(a) the injured person cannot obtain reparation under this Book from another; and

(b) liability to make reparation would be equitable having regard to the financial means of the parties and all other circumstances of the case.

COMMENTS

A. The Article in overview

Matters covered. This Article deals with issues of intention and negligence on the part of persons under eighteen. The provision thus leaves all grounds of accountability in Chapter 3, Section 2 (Accountability without intention or negligence) unaffected. These do not hinge on intention or negligence. It is the objective criteria for accountability which are far more crucial under that Section; for the most part it turns on the liable person's capacity as a keeper of a thing or an animal.

Purpose. The purpose of paragraph (1) is to particularise the general standard of care in VI.–3:102 (Negligence) sub-paragraph (b) for children between seven and seventeen years of age. The provision relates to the personal liability of children in relation to third parties. The liability of parents for the misconduct or defaults of their children is the subject of VI.–3:104 (Accountability for damage caused by children or supervised persons). Paragraph (2) clarifies that children who have not yet attained their seventh year are in principle liable for neither intention nor negligence. Paragraph (3) provides a counter-exception for the case in which the relief for persons under eighteen provided for in paragraphs (1) and (2) would lead to unjust results, in particular in view of the financial circumstances of the parties involved.

Persons under eighteen. The Article does not use the expression “minor”, rather speaking of persons under eighteen. The reason for this is that while persons who have attained the age of eighteen, are indeed of full age everywhere in the EU, this sentence is not capable of being

inverted. It may be, for example, that married persons attain the legal status of an adult before that age. They also benefit from paragraph (1).

B. Intention; violation of a statutory norm of conduct

Intention. Paragraph (1) provides clarification that this provision only involves the concretisation of the general duty of care in relation to minors. Thus, liability in negligence in the form of a violation of a statutory norm of conduct, as well as liability for intention, remain unaffected. Apart from paragraph (2) there is no special rule for the latter. Its definition in VI.-3:101 (Intention) is determined consistently by reference to “subjective” elements. For that reason the definition appears equally fitting in relation specifically to persons under eighteen. It is particularly decisive that it not only depends on the fact that the person acting wanted to do exactly what was done, rather than it was clear to that person that the conduct would well-nigh certainly inflict legally relevant damage on another. This will be often lacking in children in their early school years. Conduct which for adults would have to be readily qualified as intentional, can be merely negligent for young persons, whether because they could not clearly anticipate the danger due to lack of experience or because their desire to play relegated all other concerns to the background.

Illustration 1

In order to scare their disfavoured neighbour, several ten-year-olds inform her in conscious knowledge of its falsity that her husband was severely injured in a traffic accident and was lying in hospital. Children of this age are not normally aware of the danger of severe mental harm. Therefore, they did not intentionally cause the damage to the mental health of the neighbour.

Illustration 2

Two children aged seven and ten throw stones at moving vehicles from a motorway bridge. The boys are not in a position to comprehend what they are doing; the tragic death of a driver, whose windscreen is smashed by one of the stones, was not intentionally caused by them. In contrast, in the case of an adult who throws stones at the windscreen of a moving car, there is usually *dolus eventualis* in respect of the driver's death.

VI.-3:102 (Negligence) sub-paragraph (a). Neither does the present Article lay down a special rule in respect of VI.-3:102 (Negligence) sub-paragraph (a) (failure to meet a statutory standard of care). This is because there is no need for such a rule. If a statute lays down a specific duty of care for a defined area of life (e.g. for road traffic), that standard must be met by everyone – including minors. Most of the standards of care stipulated by statute are in any case not directed at activities undertaken by young persons. In fact they typically pertain to working, business and professional life, and hence to matters which are not generally accessible to minors anyway.

C. The general standard of care for persons under eighteen (paragraph (1))

A group-specific standard of care. Paragraph (1) has the aim of assessing the conduct of children and juveniles aged seven to seventeen by only using a standard of care which takes into consideration their youth and thus their lesser experience compared with adults. A twelve-year-old girl must only behave as can be expected of a girl of this age under the circumstances of the case, a fifteen-year-old boy, as may be expected from a boy of this age.

The older children and youths become, the more the care expected of them approaches the care expected of adults.

Illustration 3

A 16-year-old boy, who grew up in the mountains, chooses a dangerous route for an excursion with a group of other minors, during which he kicks off a stone, which severely injures a member of the group. The age and experience of the 16-year-old allow him to comprehend and foresee the danger to which he would expose others. Consequently the route planning was negligent.

Illustration 4

During their stay at a holiday camp, five youths aged between twelve and sixteen buy two bottles of caustic acid and a roll of cooking foil in the campsite shop in order to carry out an experiment with a bottle of Coke with the aim of causing an explosion. After the experiment, they hide one of the bottles containing the chemicals in a small house at the edge of the campsite, where it is found by smaller children aged below ten. One of them throws the bottle against the wall of the house, smashing it. Some of the fluid splashes in the eye of one of the small children involved, causing blindness. The two 12-year-olds, who had participated in the experiment, could neither anticipate the dangerousness of their actions nor withstand the influence of the older members of the group. The latter ought however to have reckoned with endangering younger children at the campsite. They are solidarily liable along with the proprietor of the shop and the parents involved, who breached their supervisory duty. In the internal relationship with the other solidarily liable parties, the liability of the 16-year-olds is however reduced to zero due to their very slight fault.

D. Children below the age of seven (paragraph (2))

No liability in principle for intentional or negligent infliction of damage. Paragraph (2) provides for an age limit whereby children under seven years of age are not accountable for causing damage intentionally or negligently. The provision opts for a normative proposition that, for the purposes of VI.-1:101 (Basic rule), children under seven years of age are not capable of causing damage either intentionally or negligently (although, from a purely factual point of view, the contrary notion may certainly be entertained). Hence, this involves neither a presumption of the incapacity to commit fault, which the claimant may rebut, nor a rule allowing children to prove that they do not yet have the ability to distinguish right from wrong at their disposal. In fact the provision cuts out all issues of this type. This appeared to the Study Group to be the most effective means of protecting children from premature liability. For its part, such protection is indispensable in order to prevent minors from later entering adulthood with a burden of debt, which makes self-determined life choices impossible. On the one hand, the age limit of seven years seemed realistic because the development of a true-to-life standard of care for children under this age is scarcely possible. On the other hand, too great a chasm in liability also does not arise through the age limit because, in the case of harm by small children, usually (if not always) the parents incur liability; see VI.-3:104 (Accountability for damage caused by children or supervised persons).

Strict liability remains unaffected. The liability of children due to one of the fact situations set out in Chapter 3, Section 2 (Accountability without intention or negligence) remains unaffected by VI.-3:103(2). Of course, children of this young age will rarely be the keeper of a dangerous animal or thing. They can however be the owner of a thing occasioning damage, e.g. a building.

E. Liability according to equity and fairness (paragraph (3))

Purpose of the rule. A significant aim of the rule in paragraph (2) is to safeguard children from premature financial burdens through liability for damage caused by them. However, in special, rather rare individual cases this purpose can be dropped for purely factual reasons. It can exceptionally turn out that a child (e.g. as a result of an early inheritance) is readily in a financial position to provide reparation for damage done, whereas the injured person may be in a position of financial difficulty and may be unable to bear the burden of the damage alone. In such a case equity and fairness demand reasonable reparation of the damage. Paragraph (3) adopts a legal idea which is to be found in many (but by no means all) European legal systems.

Situations embraced by the liability. Liability according to equity and fairness represents a counter-weight to the rules of both the preceding paragraphs. It corrects where necessary not only the effect of paragraph (2) (children under seven years of age), but also the effect of paragraph (1) (age-specific standard of care). Therefore, there is also room for liability according to equity and fairness where an adolescent satisfies the standard of care for his or her age group, but did not behave as would have been expected of an adult under the circumstances. In practice, the second group of cases can even be more important than the first.

Subsidiarity of liability according to equity and fairness (sub-paragraph (a)). There is no room for personal liability of small children according to equity and fairness where the injured person can obtain damages by other means. This is again typically the case where parents or other persons who are obliged to supervise the child cannot prove that they reasonably performed their supervisory duty, see VI.-3:104 (Accountability for damage caused by children or supervised persons) paragraph (4). There are also other conceivable situations, e.g. where a six-year-old in collaboration with a 10-year-old, throws stones at windows, for which the 10-year-old is readily responsible under the law on liability. A third party's ability to pay reparation must of course always be taken into account along with the legal responsibility; where the ability to pay is lacking, then the injured person simply cannot "obtain reparation" from another. The third party must ultimately have been liable "under this Book". The issue of what influence existing insurance cover has on the liability according to equity and fairness is not a question of its subsidiarity, rather a question of its other requisites.

Liability to make reparation must be equitable (sub-paragraph (b)). What matters is an overall assessment of all the circumstances of the individual case, among which the financial circumstances of the parties (the child and the injured person, not infrequently also a child) are particularly significant, while not necessarily solely decisive. It will also have to be taken into account e.g. whether "inherently" harmless infantile behaviour is concerned or deliberate harm. Another relevant factor is whether there was contributory fault on the part of the injured person, as this normally rules out a claim according to equity and fairness. On the other hand, the insurance cover of the parties involved is a factor in the assessment of their financial circumstances. Where the injured person is sufficiently insured through personal insurance cover equity and fairness do not require a permission to pursue the child personally; alternatively, the child is unaffected by liability as against an uninsured injured person if and in so far as the family indemnity insurance of the parents also encompasses their children – in this case their liability according to equity and fairness. Ultimately, equity and fairness must also justify the reparation of the damage actually claimed. This justification can be lacking, e.g. where, in cases in which major physical harm or health damage is concerned, reparation of non-economic losses is also claimed.

VI.-5:301 (Mental incompetence). Children are not on the same level as mentally disabled adults. VI.-5:301 (Mental incompetence) is therefore of no relevance to infants. However, it is conceivable that an adolescent who suffers from a mental disability could rely on this provision. Such an adolescent has the same defences available as fellow sufferers who are adults.

VI.-3:104: Accountability for damage caused by children or supervised persons

(1) Parents or other persons obliged by law to provide parental care for a person under fourteen years of age are accountable for the causation of legally relevant damage where that person under age caused the damage by conduct that would constitute intentional or negligent conduct if it were the conduct of an adult.

(2) An institution or other body obliged to supervise a person is accountable for the causation of legally relevant damage suffered by a third party when:

(a) the damage is personal injury, loss within VI.-2:202 (Loss suffered by third persons as a result of another's personal injury or death) or property damage;

(b) the person whom the institution or other body is obliged to supervise caused that damage intentionally or negligently or, in the case of a person under eighteen, by conduct that would constitute intention or negligence if it were the conduct of an adult; and

(c) the person whom the institution or other body is obliged to supervise is a person likely to cause damage of that type.

(3) However, a person is not accountable under this Article for the causation of damage if that person shows that there was no defective supervision of the person causing the damage.

COMMENTS

A. General

Subject matter of the rule in VI.-3:104. While VI.-3:103 (Persons under eighteen) relates to the personal liability of minors, the subject matter of the present Article is liability of persons (natural and legal) who are obliged by law to provide parental care. It concerns not only liability for damage caused by persons under eighteen, but also, in paragraph (2), liability for damage caused by certain adults. Paragraph (1) regulates the liability of parents (and others subject to a duty to provide parental care) for harm caused by children who have not yet attained the age of fourteen. (The present Article does not contain a specific provision for damage caused by older children; to this extent such damage remains within the general rule in VI.-3:102 (Negligence)). Paragraph (2) of the present Article provides a rule of liability for institutions inhabited by persons (under or over eighteen) who might inflict personal injury or property damage on third parties if unsupervised. Issues of personal liability of mentally disabled persons are specifically addressed in VI.-5:301 (Mental incompetence).

The regime of liability. Under paragraph (1) of the present Article persons who are obliged by law to provide parental care for a child under fourteen years of age have the liability for damage caused by the child which would have been imposed on the child, had the child already attained the age of eighteen when the harm was occasioned. Paragraph (2) contains a similar rule for cases where persons requiring supervision cause legally relevant damage to a third party, for which damage they are responsible under the general rules or, in so far as youths are involved, would have been responsible had they been subject to assessment under the standard of care for adults. Paragraph (3) clarifies that in both cases the ground of liability

is insufficient supervision. Therefore, the person under the supervisory obligation has the opportunity to provide evidence proving that reasonable supervision was carried out in relation to the person causing the damage.

No strict liability. From this and from the very positioning of VI.–3:104 in the Section 1 (Intention and negligence) of the this Chapter, it follows that these rules do not propose the imposition of strict liability on parents: having children is not a sufficient basis of liability. The protection of the family under fundamental rights prohibits socialising the advantages brought by children with one hand and individualising the disadvantages with the other. The basis of parental liability lies in that most primary right and resulting duty to take care of and supervise the child. Where the child occasions harm to a third party, then the presumption of failure to supervise takes hold. As a result the parents are obliged in such a case to present and prove that in spite of the damage, they satisfied their supervisory duty.

B. Liability for children under fourteen (paragraph (1))

The risk covered by liability. The point of liability for parents is that they carry the risk (but *only* that risk) which arises out of the circumstance that children are unable to muster the maturity and care of an adult. Such liability therefore presupposes conduct on the part of the child which, assessed according to the standards of a careful adult, amounts to negligence. Whether the child was in fact personally capable of recognising the harmfulness or at any rate the perilousness of his or her behaviour plays no role. Conversely, the mere fact that the child occasions legally relevant damage to a third party does not suffice. Where liability would not be imposed on an adult who, in the position of the child, would have done exactly as the child did, then the child's conduct does not trigger any parental liability.

Illustration 1

Children are playing in a sandpit. A boy throws sand into a playmate's face. This results in an eye injury. The boy may well not have been at all conscious of the dangerousness of his act, but it nonetheless leads to parental liability. This is because an adult acting in the same manner as the child would naturally have been liable.

Illustration 2

A holiday resort organises a water polo match for children in a designated children's swimming pool. A mother comes to the edge of the pool to take a photograph. A ball volleyed by a player hits the camera which is knocked into the water. Playing water polo in the pool was permitted; an adult exercising reasonable care would have behaved no differently from the children in the pool. Consequently, no parental liability arises. The further question of contributory negligence on the part of the mother does not come into issue.

Various age brackets. Paragraph (1) of this Article relates to harm by children under fourteen years of age. The age bracket in VI.–3:103 (Persons under eighteen) paragraph (2) (attainment of the age of seven) plays no role here. It is also irrelevant for the purposes of paragraph (1) whether the damage was caused by a child capable of comprehending the consequences of actions or one who is still incapable of such comprehension. In fact what is consistently crucial is only that the child, gauged using the standards of an adult, caused the damage negligently or in any way intentionally. The possible strict liability of a minor does not trigger parental liability. For children who have attained the age of fourteen, the injured person will again have to provide evidence of a breach of supervisory duty. Whether parents in this phase of life are in turn subject to a supervisory duty will for the most part depend on

the applicable family law. Under the general rules parents can also be subject to a supervisory duty in relation to adult offspring who are still living with them.

Persons liable. Liability under paragraph (1) affects “parents or other persons obliged by law to provide parental care”. Thus, in so far as only the two parents are entitled to parental care it makes no difference whether the child lives in the shared family household or grows up with one of the parents, or whether the parent claimed against is responsible for taking care of the household duties or pursues gainful employment. On whom the parental care and with it the supervisory duty rests in the case of broken families or unmarried parents, is decided by relevant applicable family law. “Other persons obliged by law to provide parental care” are, for instance, guardians and adoptive parents. On the other hand, stepparents remain under VI.–3:102 (Negligence), in so far as nothing different results from the applicable family law. Babysitters, nannies or childminders who take care of the child on a contractual basis do not fall under VI.–3:104(1). Of course, occasional temporary helps (neighbourly help, grandparents, etc.) are not obliged “by law”, “to provide parental care”.

Relationship to VI.–3:103 (Persons under eighteen). In principle, the liability under the present Article operates independently of the liability of a child under VI.–3:103 (Persons under eighteen). Where the requisites of liability of both Articles are fulfilled, the child and parents are in principle solidarily liable (VI.–6:105 (Solidary liability)). In their relationship to each other, liability usually of course solely rests with the parents.

Children as victims. If children are harmed by third parties, they must indeed live with their claim being reduced for personal contributory fault under the criteria in VI.–5:102 (Contributory fault and accountability), not however for a contributory supervisory failure on the part of their parents. This follows from an *argumentum e contrario* to VI.–5:102 (Contributory fault and accountability) paragraph (3), which refers exclusively to VI.–3:201 (Accountability caused by employees and representatives), not, however to VI.–3:104. Where children are harmed through a failure to supervise on the part of their parents or others subject to the supervisory duty, the claim to reparation follows the general rules or, to the extent that they are more beneficial, the rules of applicable family or contract law. If children are the victim of the actions of a third party as well as a breach of duty of their own parents, then the third party and parents are solidarily liable to the child.

C. Liability of institutions (paragraph (2))

Policy considerations. Paragraph (2) provides for liability of institutions and other bodies, which are under a duty to supervise persons who are a danger to third parties. The provision mirrors a legal situation which is to be found in a similar or at least comparable way in many of the Member States’ legal orders. Whether the persons to be supervised are under or over age makes no fundamental difference. What is far more crucial is that the institution concentrates in one area persons who require particular control. This heightened potential for danger justifies the rebuttable presumption of defective supervision in case of harm (see paragraph (3)). However, it seems appropriate to limit liability to corporeal damage, that is to say, personal injury and property damage (paragraph (2)(a)).

The duty to supervise. The duty to supervise covered here has its legal basis in the general rules on liability for omissions. It can also therefore follow from specific statutory regulations, have its basis in a contract or quite simply result from the fact that the institution, through its

assembly of persons with certain problems, has created a particular source of danger which must be kept under control according to VI.-3:102 (Negligence).

Institution or body. These rules do “not govern the liability of a person or body arising from the exercise or omission to exercise public law functions” (VI.-7:103 (Public law functions and court proceedings)). Therefore, e.g. prisons from which criminals escape do not fall under paragraph (2); the same goes for State hospitals or similar institutions catering for those who would have been convicted of a crime but for mental incapacity. Also damage caused by juvenile delinquents who have escaped from a public institution (so-called “borstal boys”) does not fall under paragraph (2) because of the effect of VI.-7:103 (Public law functions and court proceedings). Examples of the operation of paragraph (2) are provided by private playschools and private schools and boarding schools, old peoples’ homes in relation to demented inmates and psychiatric clinics with severely ill private patients.

Persons likely to cause personal injury or property damage. Persons of whom it ought to be assumed that they are likely to injure others or cause property damage if they are not supervised need not have criminal proclivities of any kind. The examples given in the previous paragraph themselves show that the issue may arise in relation to persons who are ill or children and youths who lose their inhibition to harm others when they are in a group.

Illustration 3

A depressive hospital patient jumps out of an upper storey window in order to commit suicide. He brings a pedestrian with him to the grave. The hospital is liable to the pedestrian’s survivors to the extent that it cannot prove that it properly supervised the patient.

Illustration 4

A man accommodated in a public institution for the mentally disabled sets the forest of a married couple (C) alight while unsupervised on day release. The institution is responsible for the fire damage under VI.-3:104(2).

Requisites personal to the direct injurer. As with paragraph (1), in the framework of paragraph (2) the conduct in question must be such that it would be qualified as intentional or negligent were it the conduct of an adult of sound mind. A possible incapacity to comprehend the nature of one’s actions on the part of the person directly causative of the damage is irrelevant to this extent (cf. VI.-5:301 (Mental incompetence)). In fact, such persons require particularly special supervision.

D. Defective supervision (paragraph (3))

General. In relation to both paragraph (1) and paragraph (2), it is open to the potentially liable person to prove that the damage sustained by the third party was not the consequence of defective supervision of the person causing it. The concept of “defective supervision” set out here draws on the notion of what is “defective” invoked by the Product Liability Directive (cf. VI.-3:204 (Accountability for damage caused by defective products) paragraphs (1) and (7)) and thus takes as its basis an objectified and - in comparison with VI.-3:102 (Negligence) - higher standard. It hinges on the fact that the person who was the immediate cause of the damage was inadequately supervised. It does not depend on whether this inadequate supervision was a breach of an obligation or could have been prevented by a reasonable and prudent person in the circumstances. A child who manages to wander off from its parents’

premises or play school when the parents' or teacher's attention is absorbed by more pressing problems with other children is nonetheless defectively supervised.

Illustration 5

An infant succeeds in leaving the premises of a play school for reasons later inexplicable. She walks out on to the road, where a driver manages to prevent a collision but suffers severe injury himself because he steers his car into a roadside ditch in order to save the child. The play school is liable to the driver. In contrast, the parents of the child are not liable under VI.-3:104(1) since they did not breach their supervisory duty, even using the yardstick of an objective standard. *Vis à vis* the parents, only a claim under V.-3:103 (Right to reparation) comes into the picture.

Supervision of children. With regard to the supervision of children, for the same reason, it makes no difference which parent was responsible for the defective supervision in the concrete case. To this extent, it only depends on the result – inadequate supervision of the child. If the father goes to the zoo with the child, the mother who stays at home is just as liable, and it is the same in the reverse situation of the father sitting in his office when the mother inadequately supervises the child. However, where supervision on the part of both persons entitled to custody is factually impossible (e.g. because the child lives in a boarding school far away), paragraph (3) opens up to both the possibility of being discharged of liability. It does not come down to a parental failure.

Supervision of high-risk groups. Matters are dealt with correspondingly for the case of the supervision of high-risk groups in permanent or temporary accommodation. The injured person is not obliged to single out individual employees or clarify the circumstances which led to the accident. It is sufficient that a person requiring supervision remained unsupervised and caused the damage while supposed to be under supervision.

Section 2: Accountability without intention or negligence

VI.-3:201: Accountability for damage caused by employees and representatives

(1) A person who employs or similarly engages another, is accountable for the causation of legally relevant damage suffered by a third person when the person employed or engaged:

(a) caused the damage in the course of the employment or engagement; and

(b) caused the damage intentionally or negligently, or is otherwise accountable for the causation of the damage.

(2) Paragraph (1) applies correspondingly to a legal person in relation to a representative causing damage in the course of acting as such a representative. For the purposes of this paragraph, a representative is a person who is authorised to effect juridical acts on behalf of the legal person by its constitution.

COMMENTS

A. The Article in overview

Instances of strict liability for others. This Article addresses instances of liability for others. Liability under this provision is “strict”; it does not depend on the intention or negligence of the liable person. Paragraph (1) is concerned with liability for employees and auxiliary persons placed on an equal footing to them; paragraph (2) gives effect to a structurally quite similar liability of legal persons for their representatives. The premise that employers’ liability for their personnel ought to be independent of personal fault on the part of the employer is currently representative of the legal conception in the vast majority of Member States. Even where the text of the respective codification clings to the requirement of a failure to supervise on the part of the employer, the courts have consistently attached such high requirements to the proof necessary to escape liability that, although theoretically possible under these provisions, such escape is practically a dead letter.

Liability of legal persons for their representatives. Legal persons can only act through their board members and, since the legal persons themselves simply cannot supervise liability tied to the negligent supervision by the legal person of its representatives is discarded on “technical” grounds. In other words the rule in paragraph (2) follows from the nature of the beast. It expresses a well-nigh unanimous European value judgement. A further rule on the liability of legal persons was not required. This is because VI.–1:103 (Scope of application) sub-paragraph (b) already clarifies that in principle all provisions of this Book apply in equal measure to natural and to legal persons. Under the general rules, legal persons are consequently already liable for civil wrongs which they themselves commit; see comments on VI.–1:103 (Scope of application), on VI.–3:101 (Intention) and on VI.–3:102 (Negligence). Legal persons, just as much as natural persons, are liable under paragraph (1) of the present Article for those they ordinarily employ.

Public sector bodies. The Article applies to all employers and legal persons, including the state and public sector bodies. However, where the exercise of a public law function is at stake, this Book has no application, see VI.–7:103 (Public law functions and court proceedings).

“Legally relevant damage...”. The Article covers liability for legally relevant damage of all types. Thus, although the provision declares strict liability, it is not limited bodily injury and property damage but applies to all kinds of legally relevant damage listed in the catalogue in the second Chapter. This corresponds to the legal situation in all Member States of the Union. A restriction of liability to personal injury and property damage only comes into the picture for certain forms of liability without intention or negligence (see the following Articles of this Section), not, however, in the context of employer’s liability. On the other hand, the present Article still requires that the injured person has suffered some form of *legally relevant* damage within the meaning of the second Chapter of this Book. As a result, in particular liability for “ordinary” non-performance of a contractual obligation lies outside its scope of application. Cases which have to deal with a non-performance of a contractual obligation as well as non-contractual liability for damage are conversely again subject to the general conflicts rules in VI.–1:103 (Scope of application) sub-paragraphs (c) and (d).

“... suffered by a third person”. Both paragraphs of the Article exclusively pertain to harm of “third parties”. Harm of the employee or the representative by the employer or legal person remains out of the equation, as does the reverse, *viz.* harm of the employer or legal person by an employee or representative. The same result follows to a great extent also from VI.–7:104 (Liability of employees, employers, trade unions and employers’ associations), however, only VI.–7:104, not VI.–3:201, expressly clarifies that harm of an employee by another employee

in the same company is not embraced by this Book (and that it does not make any proposals on the fashioning of personal liability of employees as against third parties).

Defences. Every defence in Chapter 5 is applicable to the liability under this Article. If such a defence is not open to the employer (or legal person) personally, but to the employee (or representative), then this likewise exonerates the employer (or legal person). This results from the fact that it is not a basis of liability simply to employ someone. The basis of liability under the present Article lies in the fact that someone has duties carried out by others. Consequently, the liable person must indeed submit to everything that would have had to be submitted to had the duties been carried out personally, but *only* to that precisely. Where there would have been no liability had the employer done (or omitted to do) exactly what the employee did (or did not do) then the delegation of duties has not become effective for the law on liability; as a consequence, there is no room for employer's liability.

B. Employer's liability (paragraph (1))

Employees. The Article provides first and foremost for liability for employees, i.e. persons who have a normal relationship of employment with their employer. However, in conformity with almost every Member State's legal system, the provision does not lay down any liability for independent (sub-) contractors and their operatives. The requisite for liability for another is always the minimum abstract possibility of directing and supervising their conduct through binding instructions. That is not the case with independent subcontractors. Liability under VI.-3:102 (Negligence) remains of course unaffected by this.

Illustration 1

In an aeroplane accident, the flying instructor and two student pilots are killed. One of the two students had been flying the plane; the flight instructor had not properly fulfilled his instructional and inspectional duties. The company which runs the flying instruction centre is liable for the flight instructor's error, although he was not its employee and in fact issued personal receipts for the flying lessons. This is because the flight instructor continuously worked in the framework of the instruction centre and had been subject to the directions of the school's operator. It was furthermore subject to the very high requirements of the duty to carefully select and monitor the instructors working at the school.

Illustration 2

A Bulgarian company obtained an arbitral award against an Italian debtor from an arbitral tribunal instituted by the Bulgarian Chamber of Industry and Trade. However, the arbitral tribunal was guilty of such gross procedural defects that the Bulgarian claimant could not obtain executory title in Italy. The Chamber of Industry and Trade is not the employer of the arbitral tribunal; it does not matter that the Chamber had published lists with the names of persons whom the parties could select as arbitrator.

Illustration 3

A sailing club rents a crane in order to bring its members' boats to land. The crane firm also provides the operating personnel. As a result of the negligence of the operating staff, a harness is broken and a boat is damaged. The specialist crane company is liable for the damage, not the sailing club.

“Similarly engages”. The Article is, however, not confined to the liability of employers. Even where the liable person and the person whose actions are in question are not connected

through an employment relationship in the technical sense, the requisites of the provision may be fulfilled. The only decisive factor is that there is a relationship of instructional dependence (or superiority and inferiority), out of which flows an authority on the part of the liable person to control the conduct of the relevant acting party. Therefore, the Article also applies e.g. where without being detected, the employment relationship was invalid or where it has been avoided with retroactive effect at the time of the injury. A contract for service (e.g. with a lawyer) can also suffice under certain criteria, namely where a lawyer is retained for a concrete task with a precisely specified line of approach and without room for personal discretion. It is not even a requirement for the application of this Article that the person acting is gainfully working for the liable person.

Illustration 4

While standing on a ski slope, a woman is hit by a toboggan driven by a first aid relief worker. The company which operates the ski slope is liable for the accident, although it does not employ the driver of the toboggan on the basis of an employment contract. A local law stipulates in detail that operators of ski slopes must arrange a transport service for injured persons. This suffices for the inference that the questionable first aid service was employed within the scope of the organised commercial activity of the ski slope operator. The fact that the aid-worker was working voluntarily and without payment does not affect this result.

A hospital is liable for the errors of its chief physicians, as long as it has the authority to determine their area of activity and to have an influence over their working hours. Where the chief physician is a member of the board, the hospital's liability then follows from paragraph (2).

Illustration 5

The negligence of a gynaecologist causes blindness to a newborn child. The private hospital is liable for this where there is a relationship of instructional connection and dependence between it and the doctor; it does not depend on the existence of an employment contract.

In the case of temporary agency workers, in principle liability falls on the company who contracts out, or supplies, the workers. If however the agency worker is integrated into the client company over a longer period of time and this is externally documented (e.g. through wearing its work uniform), then such agency workers are as "similarly engaged" (in the sense of this Article) by the client company as its own workers.

Illustration 6

An oil company is in need of an extra truck and driver for transporting oil during a few months, due to capacity constraints. The oil company contracted a transportation firm for this purpose. The driver from the firm was given an educational course by the oil company. The driver negligently caused damage to a third person when delivering oil. This is not within the work sphere of the transportation company but rather of the oil company on account of the driver having the same tasks as the company's own drivers; he was integrated into the general organisation of the company, the latter also being his supervisor and instructor. Even though the driver was hired and paid by the transportation firm, he was to be seen as a natural integrated operator of the oil company which was familiar with, and de facto supervising and instructing, the driver's work and hence was familiar with the risk.

Illustration 7

A bystander loses an eye from a chipping thrown up in the course of excavation work. The driver of the mechanical digger responsible was subject to the instruction of the construction company, although from a technical legal perspective he was an employee of a third party. The construction company is liable for the error of the driver of the mechanical digger, even though the relationship between the two parties was not permanently laid out. It suffices that the construction company insured the work of the driver and had instructional authority over him.

Temporary relief workers. The duration of engagement plays no role in the operation of this Article. A temporary worker responsible for looking after children for a couple of hours also falls under this provision. However, a contractual or quasi-contractual relationship between the party liable and the relevant person acting must always be at issue. A spontaneous favour in everyday life does not suffice.

Illustration 8

A housewife asks a guest to carry a pan of hot soup from the kitchen to the dining table, in the course of which the soup is inadvertently emptied over the trousers of another guest. The housewife is not liable under VI.-3:201 for the damage caused.

In the course of employment or engagement (sub-paragraph (a)). Liability only takes hold where the person engaged caused the damage “in the course of the employment or engagement”. The demarcation depends on whether the person acting was working within the employer’s sphere of influence or was exclusively pursuing personal aims.

Illustration 9

Where a doctor is on holiday far away from home and helps a fellow holiday-maker, harming her through negligence in the process, this does not ground any liability on the part of the doctor’s employer.

The risk of harm to a third person must have had its basis in the employment relationship. Therefore, intentional damage through employees is in principle included in the liability – this expressly results from sub-paragraph (b). Damage only lies outside the context of accountability (i.e. it only does not occur in the course of the employment or engagement), where the employee pursues entirely personal interests on occasion.

Illustration 10

A legal apprentice who is assigned to a lawyer under a civil law contract provides advice to a terminally ill woman who wishes to draw up her will. The information given by the apprentice on the requirements for formal validity is wrong; the will is void. The lawyer is liable under VI.-3:201 in conjunction with VI.-2:101 (Meaning of legally relevant damage) in damages to the “heirs” now left empty-handed. The fact that advice in testamentary matters was not part of the duties that the lawyer had allocated to the apprentice, so that the latter consciously acted contrary to instructions, does not alter the result under the law governing liability.

Illustration 11

The doorman of a nightclub is beaten up by guests. He manages to flee. He runs back to his nearby apartment and gets a knife, hurries back and pursues one of the guests,

now fleeing themselves, and severely injures him. The act occurs “in the course of the employment”. This is because the doorman had been employed for the purposes of removing riotous guests, using force where necessary.

Employees excluded from service. An employer is not liable under VI.–3:201 for employees who have already been excluded from service at the time of the injury; under special circumstances only liability under VI.–3:102 (Negligence) is otherwise conceivable, for instance because the third person should have been warned and this warning was not given.

Illustration 12

The manager of a pizzeria, the franchisee of a large chain, is shot and severely injured by a former employee of the franchisor; the latter had been dismissed by the manager. The franchisor is not liable for the shooting injury under the present Article or under VI.–3:102 (Negligence). Possible faults in the dismissal process would not have been causative of the damage; the intentional act interrupted the chain of causation.

Personal requisites of the person acting (sub-paragraph (b)). The liability of the employer arises if the employee causes legally relevant damage intentionally, negligently, or is otherwise accountable for its causation. The liability of the employer is not intertwined with the personal *liability* of the employee, rather that the latter acted intentionally or negligently within the meaning of VI.–3:101 (Intention) and VI.–3:102 (Negligence) or is responsible for damage due to one of the grounds enumerated in Chapter 3, Section 2 (Accountability without intention or negligence). That is not the same. This is because it may be that under the applicable law employees are quite generally only personally liable under special requirements, e.g. only where they are guilty of qualified fault (intention; gross negligence), see VI.–7:104 (Liability of employees, employers, trade unions and employers’ associations) sub-paragraph (a). In such a case the liability of the employer is already triggered by simple negligence on the part of the employee. The same goes for a mentally disabled employee. The mental disability exonerates the employee personally under the criteria in VI.–5:301 (Mental incompetence), but not the employer.

“...is otherwise accountable for the causation of the damage”. Liability under this Article arises not only where the employee harms the third person through intention or negligence, but also where the employee is responsible for the damage arising due to an objective ground of accountability. This can be of practical importance particularly where the responsibility of the employee personally as a keeper is at issue, for instance as the keeper of an animal (VI.–3:203 (Accountability for damage caused by animals)) or as the keeper of a motor vehicle (VI.–3:205 (Accountability for damage caused by motor vehicles)). In the case of animals or motor vehicles used by an employee professionally in the interests of the employer, it is often questionable who the keeper is. Paragraph (1)(b) relieves the injured person from the necessity of explaining in detail the internal operational circumstances relevant to the determination of who is the keeper. The employer is also liable even if in the individual case not the keeper of the thing causing the damage.

Solidary liability. According to its basic system, liability under this Article does not displace the personal liability of the employee; rather it is added to it. Thus, where the employee as well as the employer are liable under the rules of this Book or under the applicable law (VI.–7:104 (Liability of employees, employers, trade unions and employers’ associations) sub-paragraph (a); see above), then there is solidary liability (VI.–6:105(1) (Solidary liability)).

Conversely, the internal relationship between employer and employee is usually determined by a special regime of labour law, which according to VI.-7:104sub-paragraph (a) displaces the general rule in VI.-6:105 (Solidary liability) paragraph (2).

C. Liability of legal persons for their representatives (paragraph (2))

Purpose of the rule. Paragraph (2) provides for liability of a legal person for damage caused by its representatives. This rule appears necessary because a representative is not always also an employee. Incidentally, the requisites of both paragraphs in VI.-3:201 are of course identical. As a result the operation of the Article is not strained by the occasionally problematic differentiation between a “simple” employee and a representative. As long as it is certain that the person acting is to be allocated to *either* one *or* the other category, the liability of the legal person for the harmful conduct of the person acting is fixed.

Representative. The second sentence of paragraph (2) defines a representative as a person who is authorised to effect juridical acts on behalf of the legal person by its constitution. It is for the terms of the latter (charter, memorandum and articles of association, etc.) to determine the persons who are its representatives. That constitution is of course subject to the statutory rules of the legal system to which the legal person owes its existence. Paragraph (2) also applies where the representative in turn is a legal person.

VI.-3:202: Accountability for damage caused by the unsafe state of an immovable

(1) A person who independently exercises control over an immovable is accountable for the causation of personal injury and consequential loss, loss within VI.-2:202 (Loss suffered by third persons as a result of another’s personal injury or death), and loss resulting from property damage (other than to the immovable itself) by a state of the immovable which does not ensure such safety as a person in or near the immovable is entitled to expect having regard to the circumstances including:

- (a) the nature of the immovable;*
- (b) the access to the immovable; and*
- (c) the cost of avoiding the immovable being in that state.*

(2) A person exercises independent control over an immovable if that person exercises such control that it is reasonable to impose a duty on that person to prevent legally relevant damage within the scope of this Article.

(3) The owner of the immovable is to be regarded as independently exercising control, unless the owner shows that another independently exercises control.

COMMENTS

A. The legal policy

Liability for the unsafe state of an immovable. This Article imposes strict liability for personal injury and property damage caused by the unsafe state of an immovable. It is not confined to damage which has its cause in the poor state of construction or maintenance of buildings and other man-made structures, and it is not confined to damage which results from parts of these structures falling off, coming apart or entirely collapsing. In fact, the Article pertains to all types of dangers on immovables. Furthermore, it relates both to damage sustained on the land or in the building itself and damage suffered by persons or property in the vicinity of the immovable concerned, but not actually on it or in it. Liability attaches to

anyone who exercises control over the property independently and without being subject to instructions; in cases of doubt, this is the owner (paragraph (3)).

Liability is strict. Liability is “strict” in the same sense as it is strict under the Product Liability Directive: the injured person only has to show that the immovable was unsafe (in the language of product liability: “defective”), according to the criteria set out in paragraph (1). This is most clearly demonstrated by considering cases of defective construction of a building which the occupier has taken over from another (e.g. inherited). The decisive issue is not whether the occupier as such could have arranged for greater safety. Rather the decisive issue is simply whether it had been ensured that the required safety precautions were actually in place. The operator of a supermarket is accountable for the causation of damage if, in its vegetables department, foliage which has fallen to the floor and created for customers a danger of slipping is not removed and results in injury: the floor must be kept safe at all times and not merely (as would be the case if resort were had to the general standard of care) at regular intervals. Everything of course depends on the exact circumstances of the individual case: the owner of a wild wood is not obliged to ensure the safety of paths through the wood vis-à-vis recreational users; someone who operates a nature reserve for commercial purposes and attracts visitors to that end is bound to ensure their safety.

Policy considerations. The Article corresponds to the current legal situation in several Member States of the EU, but in many respects goes beyond the present state of legal development there. To the extent that this is the case, the justification is the protection of the victim, taking into account that the owner of an immovable should in any case have reasonable insurance cover and that in many situations there are no sufficient grounds for distinguishing between damage through defective products and damage through unsafe immovables: if a customer in a supermarket has a right to damages if a bottle of mineral water explodes on being picked up, then the customer also ought to have a right to damages if injured by stepping on a glass shard in the drinks section. A further argument in favour of the solution opted for in the Article, is the fact that even in those legal systems which have at least theoretically held on to liability for immovables connected with negligence, the borders between liability for, and without, negligence no longer lend themselves to being authoritatively defined; quite apart from the other fact that numerous reversals of the burden of proof have further contributed to the situation that adherence to the so-called “fault principle” has increasingly taken on the features of mere lip service. The solution in the present Article is further supported by the consideration that the injured person is often left with no other choice than to go on to another’s property, without being able to deal sensibly with hidden dangers present there. In contrast, it must normally be expected that the person responsible for the property should be aware of these dangers and should deal with them in a reasonable manner. The way in which paragraph (1) is phrased takes account of the fact that this argument does not apply to undeveloped land in the open countryside. Finally, it would not be consistent with present-day legal understanding to distinguish in principle between, on the one hand “constructs” (man-made structures), and on the other hand “natural” dangers of an immovable (falling trees; black ice on the way to the front door); this is just as weak as distinguishing for the purposes of the law on liability between, on the one hand, matter that falls downwards and, on the other, unevenness in the ground or an excavated pit.

Legally relevant damage. In conformity with all the provisions of Chapter 3, Section 2 (Accountability without intention or negligence), the liability under this Article is limited to cases of death, personal injury and property damage (as defined in VI.–2:206(2)(b) (Loss upon infringement of property and lawful possession)). Only damage of this kind is within the

protective purpose of liability due to the realisation of dangers on immovables. In relation to liability for all other types of damage, the necessity for intention or negligence remains.

Public roads excluded. Excluded from the scope of application of the present Article is the liability of the State and its organs, in so far as they attend to or omit to attend to public law duties in relation to public roads. This follows from VI.–7:103 (Public law functions and court proceedings).

Relationship to VI.–3:206 (Accountability for damage caused by dangerous substances or emissions). The present Article concerns the liability of the person who is responsible for the dangerous state of the land or building. VI.–3:206 (Accountability for damage caused by dangerous substances or emissions) relates to the liability of those who are responsible for dangerous substances or installations which release or discharge substances or emissions dangerous to the environment. VI.–3:206 (Accountability for damage caused by dangerous substances or emissions) is concerned essentially with dangers arising from an enterprise or undertaking, whereas the present Article is concerned with “static” dangers which are inherent in an immovable. It is conceivable that in exceptional cases the requirements of both provisions may be satisfied simultaneously (in which case the claimant may rely on whichever regime is the more advantageous), but they remain clearly distinct in their tenet. The present Article is solely geared to the unsafe state of an immovable (“state” including both the condition of the immovable and its features). Furthermore, it is directed at risks for persons “in or near the immovable”; that is not the case for VI.–3:206 (Accountability for damage caused by dangerous substances or emissions) (which also covers mobile installations).

Illustration 1

Only this Article (and not VI.–3:206 (Accountability for damage caused by dangerous substances or emissions)) is relevant if someone is injured by a roofing shingle which falls from a roof or if a customer of a bank with access to a safe suffers a shock after a door slams to behind him, locking him in, because no emergency call system has been installed. On the other hand, it is only VI.–3:206 (and not the present Article) which is relevant if the danger in question arises not from the state of the land or a building, but from the use of a building in a particular way. A building is not unsafe merely by reason of the fact that fireworks are stored there; a public house is not unsafe simply because it runs a disco.

Relationship to contract law. The relationship between liability under this Article and liability under contract law is subject to the general rules of VI.–1:103 (Scope of application). A lessee, for example, can invoke the present Article unless the relevant law governing leases contains provisions which would lose their effect were the rules of non-contractual liability applied. By the same token, the rules in the present Article leave unaffected not only the general non-contractual liability for negligence, but also a basis of claim in contract that is more favourable to the lessee.

Illustration 2

X rented rooms in Y’s building for the pursuit of a tailoring business. A fire breaks out in the storage room; items belonging to X are burnt, along with items of clothing that belong to his customer C. The fire can be traced back to the accumulation of soot in the chimney, which had ignited, causing an explosion, which itself left a hole in the wall. X and C have a claim against Y under VI.–3:202 for the damage suffered to their

respective property; the building was clearly in an unsafe state. Y cannot exonerate himself by proving that he contracted a chimney-sweeper for the regular cleaning of the chimney. X can also base a claim for damages in contract law (VI.–1:103(d) (Scope of application)), which can be more favourable to him because (i) it compensates for the lost profit that results from the temporary standstill in business operations and (ii) the fire is not attributable to force majeure (see III.–3:104 (Excuse due to an impediment)). Also, in relation to the issue of whether X can have recourse against Y for the damage that X suffers because he must replace C’s burnt suits under the applicable contract law (which may be assumed here), it would be more beneficial for X to claim damages under contract law. This is because under the law on non-contractual liability for damage this element only constitutes legally relevant damage (VI.–2:101 (Meaning of legally relevant damage)) where Y had acted negligently. However, this is lacking here.

Defences. The defences in Chapter 5 of this Book also apply to claims under the present Article. Of particular practical significance is VI.–5:302 (Event beyond control), which can rule out liability for the realisation of dangers on immovables as a consequence of extreme weather conditions.

B. The risk embraced by liability

Basis. The liability under VI.–3:202 relates to personal injury and property damage which arises because an immovable does not come up to standard of safety which persons who find themselves on it or in it or in its vicinity may reasonably expect. The type of hazard plays no role. The Article can cover cases where parts of a building or structure become detached, where a gravestone falls over in a cemetery, where the floor of a house is slippery from being over-polished and a corresponding warning to the public is lacking, where a tree falls over, where an icy footpath is not treated with grit and there is no corresponding sign, where a pit has not been secured or where the water extraction system in a swimming pool is set so high that children who are caught by its suction when diving cannot free themselves from its pull.

Illustration 3

Sloped premises are unsafe where frequent torrential rainfall occurs in the area and the water drainage system does not function properly, so that walls on a neighbour’s property situated below break under the pressure from a mudslide.

Immovable. “Immovable property” is defined in Annex 1 as “land and anything so attached to land as not to be subject to change of place by usual human action.” This clearly covers buildings, permanent bridges and similar structures. The term immovable is not further defined for the purposes of this Article. This appeared neither possible nor necessary because the Article does not depend on technical issues. In fact it usually suffices for the term immovable as used in this Article to equate it in a natural sense with “premises”. Where the goals on a football field designed for competitive sport fall over from even light contact, this sports ground is unsafe for its users regardless of whether the goals formed an essential part of the football field or not.

“Other than to the immovable itself”. In cases of property damage, accountability under this Article is limited to damage to other items of property than the premises themselves. This restriction has been formulated following the corresponding rule in the Product Liability Directive (see VI.–3:204(1) (Accountability for damage caused by defective products)). It

seemed necessary in order not to disturb the numerous special regimes of landlord and tenant law and residential property law.

Illustration 4

A chimney jutting high above the roof of a block of apartments collapses; stones break through the roof into an apartment situated below. Its owner cannot hold the owners of the other apartments accountable under VI.-3:202.

“In or near the immovable”. It makes no difference to the liability under VI.-3:202 whether the harm comes about on or in the premises or outside the premises but near to them: the owner is liable for the damage caused by parts of a building falling away or a tree falling over, regardless of whether the victim is hit while on the premises or on a footpath belonging to someone else or in a public car park.

“Such safety as a person ... is entitled to expect”. The test decisive for liability is whether the premises lacked the safety which the injured person could reasonably have expected under the circumstances. The test is an objective one, to be applied from the standpoint of the injured person in or near the immovable. Quite what is “safe” depends on the particular circumstances. The concept is based on the notion of what is ‘defective’ adopted in the product liability defective.

Illustration 5

An adventure playground for children may well involve some risks because it otherwise would not be an adventure playground.

Illustration 6

In contrast, a ski slope is unsafe if it has an integrated liftmast whose sharp edges are not padded by bails of straw or by other means.

The nature of the immovable (paragraph (1)(a)). It is in the nature of the matter that the safety which can be expected from an immovable depends on all the circumstances of the particular case. Among these circumstances is the kind of land or the kind of premises involved and the kind of danger which is present. A person who strolls around private gardens open to the public can expect a different type of safety to someone collecting mushrooms in the forest, who can at most reckon with warning signs in particularly dangerous spots and this only in a recreational area close to urban life.

The access to the immovable. It is also important to identify whether the case involves land or premises on to which people have been invited by a person entitled to do so or land or premises on to which people may come against that person’s will. In the latter case the standard of safety which the public can expect is much lower than in the former. Someone who is in an area of danger without authority can naturally expect less safety (the matter may be otherwise in relation to children) and a thief or another person who violates the sanctity of the home cannot basically expect any safety at all.

Costs. Only such a standard of safety can be ultimately expected as can be produced with reasonable cost under the circumstances. Therefore, often warnings of certain dangers must suffice; to this extent, of course, everything depends on the circumstances of the individual case. Where a pit is excavated in the course of construction work, it must be fenced in and the

fence must be lit up at night; a mere warning sign is certainly insufficient here. Furthermore, the amount of expenditure must be in reasonable proportion to the type of risk. More must be done to protect against dangers to life and limb than to protect against dangers to property.

Illustration 7

Subsequent to an accident in the outside lane of a motorway, the passenger of the vehicle attempts to seek safety from the fast-moving traffic by leaping over the crash barrier. Between this and the crash barrier on the opposite carriageway there is a dangerous twenty metre drop, into which the passenger plunges to her death. The drop between the carriageways was not discernible in the darkness. The structure of the elevated motorway was unsafe at this point. The operator of the motorway is liable under VI.–3:202., However the person causing the car accident is not liable because the fatal plunge is no longer to be qualified as a consequence of the accident, see VI.–4:101 (General rule [on causation]).

C. Persons liable

Policy considerations. There is no uniformity between the various European legal orders as to the question on *whom* the liability should be imposed. Essentially the owner, the person possessing for himself or herself (in contrast to a mere *detentor*) and the occupier come into focus. Against this backdrop, the Group proposes a compromise. Under VI.–3:202 the basic rule is that the liability is that of the person “who independently exercises control”. In relation to the victim, however, it is (rebuttably) presumed that the owner of the immovable is the person who independently exercises control (paragraph (3)). In order to prevent an amicable solution to the problem of liability for an immovable collapsing (so to speak) simply because of the different concepts of “ownership” in relation to immovables in the various jurisdictions, it is left to national laws to determine what is meant by an owner of an immovable. In the countries that have land registries at their disposal, for the most part this does not present a problem; here the owner of the premises is also the person whom the injured person may identify most easily and thereby minimise the procedural risk. This fact also justifies the policy decision behind paragraph (3).

Paragraph (2). Paragraph (2) furnishes an additional clarification as to the persons who may be liable because they are exercising independent control. The primary source of inspiration for paragraph (2) is the definition of “occupier” in the Irish Occupiers’ Liability Act 1995, section 1(1). Despite its partial circularity it expresses all the essential elements. In any given case the outcome of this criterion will depend on all the circumstances. In the case of larger residential property it may be that different persons are occupiers in relation to different parts of the property. A tenant of a flat is capable of being an occupier of the rented area. During the building phase, the construction company is liable for the safety of the building site and the stability of the scaffolding erected by it.

Occupier and keeper. The definition of the person who independently exercises control (“occupier”) was restricted to immovables because the policy question of who is to be burdened with liability for damage caused by an unsafe immovable cannot in all cases be satisfactorily addressed by a purely factual assessment as in the case of keepers of motor vehicles, animals and substances in determining whether there should be accountability without intention or negligence. The situation for immovables is distinguishable from that of motor vehicles or animals because with immovables (e.g. large buildings) different parts may be under the control of different persons. The concept of a keeper is not designed to cover such situations.

Paragraph (3). Under paragraph (3) the owner can show “that another independently exercises control”. In such a case liability does not attach to the owner, but to the third person. A person who has leased out a large complex of commercial premises is not responsible for the state of the commercial units within the complex; a person who lets out an apartment is not responsible for the quality of the carpet laid by the lessee. The owner of an empty house is not faced with liability for damage which has its basis in its neglect if youths occupy the house and the police are afraid to cause a stir by initiating a move to evacuate the house. However, in such a case the owner must do everything possible to put the occupation of the house to an end; otherwise there may be liability for negligence.

Abandonment. Under VI.–3:208 (Abandonment) a person who abandons an immovable remains accountable for it up until the time when another person exercises independent control over it. For further details see the comments on that Article.

VI.–3:203: Accountability for damage caused by animals

A keeper of an animal is accountable for the causation by the animal of personal injury and consequential loss, loss within VI.–2:202 (Loss suffered by third persons as a result of another’s personal injury or death), and loss resulting from property damage.

COMMENTS

A. General

Strict liability for animals of all types. The Article provides for strict liability for animals of all types, without distinguishing between animals kept as household pets or for business purposes, between domestic and wild animals, or between native and foreign species. The provision thus follows the prevailing approach of the Member States’ legal systems. Even where individual groups of animals have been excluded from strict liability in principle, such special rules are today frequently met with considerable political criticism. Liability for the realisation of the dangers inherent in animals should lie with their keepers independently of personal negligence (or the negligence of their workers). This is widely acknowledged in Europe today and represents the applicable law.

Animals living in the wild excluded. Liability only arises, however, in respect of animals which are “kept”. Wild animals, living in the wild, are therefore not within the scope of this rule. Damage caused by game is generally subject to its own regime. Its idiosyncrasies are not covered by the present Article, see VI.–3:207(a) (Other accountability for the causation of legally relevant damage).

Legally relevant damage; relationship to contract law. As with all cases within Chapter 3, Section 2 (Accountability without intention or negligence), liability under VI.–3:203 only relates to death, personal injury, health injuries (e.g. infection with a disease) and property damage. On the other hand, the scope of protection also encompasses a person who temporarily exercises control of the animal, without being its keeper, e.g. someone who takes another’s dog for a walk or who rides another’s horse. Where a contract for the care of the animal was concluded between the victim and the keeper, liability depends on whether the

regime of contract law demands primacy of applicability (VI.-1:103 (Scope of application) sub-paragraph (c)).

Illustration 1

K, who runs a home for cats and dogs, takes a sheepdog which had been left with her for a few days out for a walk. The dog recognises a place where it has the opportunity to run free and pulls so fiercely on the leash that K falls and breaks her wrist, which leads to prolonged pain and inconvenience. The applicable law of contract provides for liability of a person who, providing payment, temporarily gives over an animal for care only where negligence is present. This interpretation results in the situation that the stipulation under contract law seeks to provide a conclusive rule. Since there is no negligence evident, K is not entitled to a claim in damages.

Defences. The defences in Chapter 5 also apply in relation to the liability of the keepers of animals. In the area of equestrian sport, the rider's claim in damages against the keeper of the horse will therefore often fall at the hurdle of VI.-5:101 (Acting at own risk) paragraph (2). Where one animal injures another, VI.-5:102 (Contributory fault and accountability) paragraph (4) is of particular note.

Illustration 2

A dog belonging to Carlos but whose possessor and keeper is his sister Esther enters the injured person's rabbit farm and causes the death of 73 'mother rabbits', the miscarriage of 12 other 'mother rabbits' and the death of several baby rabbits. Esther, not Carlos, is liable for this damage. Due to the fact that the owner of the farm had left open the gate to the area in which the rabbits were kept and that the damage would not at all have arisen had the gate been properly closed, the damages are reduced to approximately 80%. A further reduction as a consequence of the fact that there was also strict liability for the rabbits, does not, however, come into play. This is because there was no danger inherent in the rabbits.

Illustration 3

K's dog, who is off the lead, fights with another dog (kept by B), likewise not on a leash. K attempts to separate them but is permanently injured by B's dog in the process. K did not accept the risk of injury solely because she let her dog walk around without a leash. However, she must face a reduction in her claim because her own dog was actively involved in the occurrence of the accident.

B. Damage caused by animals

Animal. The notion of an animal is not necessarily being used here in a biologically exact sense. Rather it is the conventional notion of ordinary language which forms the basis of all rules on the liability of a keeper of an animal. Consequently, bacteria (and in any case viruses) are not animals within the meaning of VI.-3:203. That proposition also follows from the fact that VI.-3:206 (Accountability for damage caused by dangerous substances or emissions) paragraph (2) envisages a special regime for micro-organisms. The practical outcome is that the smallest animals in the sense invoked by VI.-3:203 are insects.

Causation by the animal. In keeping with the preponderant majority of the existing statutory rules, VI.-3:203 does not (i) single out particular modes of causing damage or (ii) confine liability to the realisation of dangers specific to animals. The criterion of causation in VI.-4:101 (General rule) is flexible enough to avoid absurd outcomes (e.g. a cat does not

“cause” damage if it is thrown by someone at the victim, who is thereby injured). The rule proceeds on the basis, however, that animals (as is also the case for things) are capable of “causing” damage. The concept of causation in the draft is not confined to human conduct. See further VI.–1:101 (Basic rule).

Notion of keeper. The concept of a “keeper” is of general significance for the entire law on non-contractual liability. It is invoked in these rules not only within the framework of liability for animals, but also in the regimes under VI.–3:205 (Accountability for damage caused by motor vehicles) and VI.–3:206 (Accountability for damage caused by dangerous substances or emissions). The meaning is always the same: a keeper, in relation to an animal (motor vehicle or substance), is the person who has the beneficial use or physical control of it for that person's own benefit, and who exercises the right to control it or its use. The rules deliberately avoid invoking the concept of “possession”: “possession” is a concept of property law and has or may have a meaning which differs from jurisdiction to jurisdiction.

Examples. A person who rents a horse to ride at stables is not its keeper. A short-term loan by a keeper to another for that other's use does not mean that the existing keeper will lose the status of keeper. Conversely, a stable which competes at tournaments and to which a horse is rented for use in tournament events for two years is a keeper during this time. Employees who take care of their employer's animals (non-self-employed shepherds; circus workers etc.) are not the keepers of the animals. Animals which are not desired are not even “kept” at all (fleas are not “kept” – unless in a flea circus – because the individual afflicted is an involuntary carrier). Also not bearing the characteristic of keeper of an animal is an association for the protection of animals, which temporarily takes dogs and cats knocked down on the road into care in order that they are given back to their owner as soon as possible after care.

Illustration 4

V is bitten by a pit-bull terrier. X's adult daughter is the owner of the dog. For two years the daughter has lived on the third floor of an apartment building. In order that she does not have to go up and down so many flights of stairs with the dog every day, the dog lives on the first floor with X, who feeds it, cares for it and pays for the dog tax and insurance. X is the keeper and in this capacity is liable for the damage caused by the bite.

Ownership. Ownership of an animal is an important indicator of the presence of a right to control and enjoy beneficial use, but it is not ultimately decisive. There are many cases in which someone other than the owner is the keeper: examples are where an animal is acquired under retention of title or leased or where a valuable horse is loaned out under a long-term arrangement. Moreover, there are cases in which, despite someone being owner of an animal, there is no keeper: for example, wild animals may belong to the state or another public body, but, unless fenced or caged in, the state does not “keep” them.

Children. Children are as a rule not the keeper of things which belong to them. Rather it will be the children's parents as a rule who are the keeper because they enjoy the right to exercise control.

Several keepers. It is possible for an animal to have more than one keeper. In that case, they will be liable as solidary debtors. The same applies where several animals of different keepers

occasion the same damage or if it cannot be established which of these animals has caused the damage, see VI.-4:103 (Alternative causes).

Illustration 5

At a beekeeping demonstration, bees from hives belonging to several beekeepers have been disturbed and are flying about aggressively. X is severely stung by many bees. Among the bees flying about near X were bees belonging to Y, but it is not possible to establish whether X was actually stung by Y's bees. Y is liable under VI.-3:203 in conjunction with VI.-4:103 (Alternative causes).

Illustration 6

X suffers damage to her vehicle when she reverses into a flock of sheep, which are being herded on the road. There are sheep of various different owners in the flock. Since they have all caused the source of danger (VI.-4:101) (General rule), it is not only the owner of the sheep who happens to be walking at the back of the flock who is liable (VI.-6:105(1)) (Solidary liability).

Illustration 7

A victim bitten by a dog suffers severe injuries. The dog belongs to a partnership; its keepers are three brothers, each of whom is a partner. The three brothers are solidarily liable for the damage (VI.-6:105(1) (Solidary liability)).

Thieves. As a rule a thief may be a keeper. It is not possible, however, to state in general whether the former keeper's status as keeper terminates as a result of the theft. In any event the former keeper may remain accountable for damage caused by the animal on the basis of negligence if the former keeper has not taken reasonable precautions to prevent the theft: see VI.-3:102 (Negligence) sub-paragraph (a).

VI.-3:204: Accountability for damage caused by defective products

(1) The producer of a product is accountable for the causation of personal injury and consequential loss, loss within VI.-2:202 (Loss suffered by third persons as a result of another's personal injury or death), and, in relation to consumers, loss resulting from property damage (other than to the product itself) by a defect in the product.

(2) A person who imported the product into the European Economic Area for sale, hire, leasing or distribution in the course of that person's business is accountable correspondingly.

(3) A supplier of the product is accountable correspondingly if:

(a) the producer cannot be identified; or

(b) in the case of an imported product, the product does not indicate the identity of the importer (whether or not the producer's name is indicated), unless the supplier informs the injured person, within a reasonable time, of the identity of the producer or the person who supplied that supplier with the product.

(4) A person is not accountable under this Article for the causation of damage if that person shows that:

(a) that person did not put the product into circulation;

(b) it is probable that the defect which caused the damage did not exist at the time when that person put the product into circulation;

- (c) that person neither manufactured the product for sale or distribution for economic purpose nor manufactured or distributed it in the course of business;*
- (d) the defect is due to the product's compliance with mandatory regulations issued by public authorities;*
- (e) the state of scientific and technical knowledge at the time that person put the product into circulation did not enable the existence of the defect to be discovered; or*
- (f) in the case of a manufacturer of a component, the defect is attributable to:*
 - (i) the design of the product into which the component has been fitted; or*
 - (ii) instructions given by the manufacturer of the product.*

(5) "Producer" means:

- (a) in the case of a finished product or a component, the manufacturer;*
- (b) in the case of raw material, the person who abstracts or wins it; and*
- (c) any person who, by putting a name, trademark or other distinguishing feature on the product, gives the impression of being its producer.*

(6) "Product" means a movable, even if incorporated into another movable or an immovable, or electricity.

(7) A product is defective if it does not provide the safety which a person is entitled to expect, having regard to the circumstances including:

- (a) the presentation of the product;*
- (b) the use to which it could reasonably be expected that the product would be put; and*
- (c) the time when the product was put into circulation,*

but a product is not defective merely because a better product is subsequently put into circulation.

COMMENTS

A. General

Council Directive 85/374/EEC. This Article reproduces Council Directive 85/374/EEC of 25th July 1985 on liability for defective products (as amended by Article 1 of Directive 1999/34/EC). Since the liability regime under the product liability Directive undoubtedly constitutes a cornerstone of the European law on liability for damage, it did not appear sufficient simply to make reference to the Directive in the text of the Article. Rather it seemed necessary to spell out its effects in these rules.

Detailed commentary unnecessary. To the extent that the Article coincides with the Directive this text can dispense with a more detailed commentary. Reference can be had for that purpose to the voluminous literature devoted to this topic to be found in each Member State.

Restriction to consumer protection. In keeping with the fundamental legal policy adopted by the Directive, VI.-3:204 is restricted to matters of consumer protection. For that reason it deliberately refrains from extending strict liability to "business to business" relationships. Such a step would depart from the Directive's purpose of consumer protection and entail a wide-ranging interference with freedom of contract – quite apart from the fact that to date there have been no audible demands in the business sector that a corresponding liability regime be established. Rather the complete opposite is the case. The European Commission, which posed the question whether product liability should be extended to business property in its Green Paper of 28 July 1999 (COM(1999) 396 final, p. 31), stated in its report of 31

January 2001 on the application of the product liability Directive (COM(2000) 893 final, p. 25) that the tenor of responses was “in general negative” and “[o]n the basis of data available it does not seem appropriate to amend the Directive on this point”.

Burden of proof in relation to damage to business property. Given this background, VI.–3:204 likewise does not provide for a reversal of the burden of proof to the detriment of the producer of the sort adopted in a few of the legal systems not just for “B2C” cases, but also for “B2B” cases. Such rules have the effect of presuming negligence to the producer’s detriment if one of the products causes damage to another’s business property. Where those rules are to be found in the law currently in force, their practical effect is barely distinguishable from a strict liability.

No contractual exclusion or restriction of liability. VI.–3:204 must be read in conjunction with VI.–5:401 (Contractual exclusion and limitation of liability) paragraph (3). By virtue of the latter Article, liability under VI.–3:204 can neither be restricted nor excluded before the occurrence of the damage. This, too, follows from the product liability Directive (art. 12). The nullity of an exclusion of liability relates both to personal injury and damage to consumer property.

No punitive or aggravated damages. The draft does not provide for punitive damages in general and the law on product liability does not constitute an exception. Since VI.–3:204 is concerned with strict liability and no element of fault is required, the introduction of punitive damages in this context must be completely out of the question.

Primary agricultural products and game. Since Directive 1999/34/EC art. 1(2) came into force, Directive 85/374/EEC no longer permits Member States a decision-making power in regard to whether or not primary agricultural products and game should be subjected to strict liability. VI.–3:204 reflects this legal development. Products of this type are included in its scope of application.

Liability for development risks. The draft follows the Directive also in its approach to liability for so-called “development risks”. Under VI.–3:204(4)(e) there is no strict liability if the producer shows that the state of scientific and technical knowledge at the time that person put the product into circulation did not enable the existence of the defect to be discovered. That rule must, however, be read in conjunction with VI.–3:207 (Other accountability for the causation of legally relevant damage) sub-paragraph (c) which, like Council Directive 85/374/EEC art. 15(1)(b), leaves to the national legal systems the option not to introduce this ground of defence into their law. The various jurisdictions do not assess in a completely uniform way, however, the conditions under which it may be said that the risk which has realised is merely a ‘development risk’. The ECJ in its judgment of 29 May 1997 in *Commission v. United Kingdom* C-300/95 (ECJ Rep. 1997, I-2649) at para. 29 defined in the following terms how the concept deployed by the Directive is to be understood: “the producer must prove that the objective state of scientific and technical knowledge, including the most advanced level of such knowledge, at the time when the product in question was put into circulation was not such as to enable the existence of the defect to be discovered. Further, in order for the relevant scientific and technical knowledge to be successfully pleaded as against the producer, that knowledge must have been accessible at the time when the product in question was put into circulation.” In so doing the court essentially adopted the Opinion of Advocate-General *Tesauro*.

Policy considerations. The question whether product liability should also embrace liability for development risks has been and remains a matter of controversial discussion at the level of legal policy in many Member States. According to a study in 2003 by the *Fondazione Rosselli* compiled for the European Commission the argument that the risk concerned was a development risk has only rarely been successful. To date it has been pleaded as a defence primarily in proceedings relating to blood products and their derivatives, medicines and vaccines, foodstuffs and chemicals. (For further information see http://europa.eu.int/comm/enterprise/regulation/goods/liability_de.htm). The study concludes by advocating the retention of the development risk defence. One of the reasons put forward is the difficulty of finding a reasonable cover for the risk on the insurance market, an aspect which the European Commission also emphasises in its report referred to in the third paragraph of this Comment. Moreover, mention is also made of the concern that the propensity to innovate and the range of industrial products might otherwise diminish.

Further considerations. These rules consider – in agreement with the studies referred to – that the current regime in the Directive is a balanced one. It does not appear to have caused difficulties in practice or gaps in liability which cannot be easily accommodated. It is sufficient to leave the decision as to maintenance or abolition of the development risk defences to the national legal systems. They (i) enjoy as a result the freedom to define the concept in a manner which appears to them to be reasonable and (ii) retain the freedom to abolish the defence only for defined products with special potential for hazard (blood products, medicines, genetically modified produce) and to create the necessary insurance framework.

Application of the general provisions. In accordance with Council Directive 85/374/EEC art. 13, VI.–3:204 leaves other causes of action unaffected. Product liability based on the law on non-contractual liability for negligence and on contract (see VI.–1:103 (Scope of application) sub-paragraph (d)) remains applicable. That is of practical significance in particular in reference to damage to property of businesses or professionals. Compensation for damage to property (as a result of a defective product) which a business causes to *another business* is consequently (as already indicated) only obtainable under the rules on non-contractual liability if the injured person can prove that the person causing the damage did so intentionally or negligently.

Duty to warn of development risks. The exclusion of strict liability for development risks does not then simultaneously mean an exclusion of liability for negligence. Such liability can arise in this context if the producer breaches duties to warn in relation to the realisation of development risks that have only become apparent after the product has been put on the open market and of which the consumer would have been made aware by a producer monitoring its products with reasonable care.

Deviations from the Directive; options left to discretion of Member States. VI.–3:204 departs from the Directive on one point (there is no excess provision for consumers suffering property damage) and VI.–3:204 also proposes that the options left by the Directive to the Member States in respect of non-economic losses and the introduction of a quantitative ceiling on liability be superseded by solutions which are in harmony with the general approach of these rules).

B. Damage to consumer property

Deviation from the Directive. Departing from the Community law currently in force (Product Liability Directive art. 9(b)), VI.-3:204 proposes to extend the strict liability of a producer in favour of consumers to damage to property which amounts to less than €500. (The Directive originally provided for an excess of 500,- ECU. Council Regulation EC/1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro [OJ L 162, 19 June 1997, p. 1] art. 2 converted that sum into € 500). It may well be that for such small levels of damage solutions outside of the court system ought to be found. The Commission report referred to in paragraph 3 of these Comments mentions this topic, but does not go into any detail.

Policy considerations. A primary explanation for the excess for consumers in relation to property damage which has been given is that producers, insurers and the courts ought not to be burdened with proceedings in respect of trivial sums and, furthermore, that a limit of this nature reduces transaction costs. However, tending against the rule are the facts not only that it constitutes a rather singular ‘foreign body’ within Community law, but that in a predominant number of the legal systems of the Member States it is practically an empty shell because both contract law and the law on non-contractual liability have developed mechanisms in the law of evidence which in terms of practical outcome cut out the producer’s defence of an absence of fault. Furthermore, in all cases of property damage which exceed the minimum limit for liability the rule leads to an unjustifiable difficulty for the consumer in the conduct of proceedings; the claim must be based in such cases on different causes of action. The rule also contributes towards new legal differences in European product liability partly because the character of the rule as a general excess is liable to fall into disrespect, but also because the Directive originally expressed the excess in terms of ECU and the Euro has not yet been introduced in all Member States. Fluctuations in currency values consequently have the effect that the amount of the excess varies not inconsiderably from country to country. Finally, a want of justice is inherent in the excess: it seems anomalous that damage to property of less than €500 is to be withdrawn from just one regime of strict liability, but to allow such damage to be compensated in all other cases (a property damage of, say, €450 is certainly not within the notion of “trivial damage” within the meaning of VI.-6:102 (De minimis rule)). The same goes for damage to property which exceeds €500 in value. From the point of view of legal policy it is hardly a convincing standpoint that if there is a damage of, for example, €20,000, compensation will only amount to €19,500, and one may speculate that in judgments for which (as is often the case) the quantum of damage depends on an estimation, the excess will be ‘reckoned in’ before the level of compensation is set.

C. Liability for non-economic losses; no maximum limit to liability

Liability for non-economic loss and injury as such. The definition of damage in the Directive is “without prejudice to national provisions relating to non-material damage” (art. 9, second sentence). Since the rules in this Book do not generally distinguish between economic and non-economic loss, the term “loss” consequently embracing loss of a non-economic nature (see VI.-2:101(1) (Meaning of legally relevant damage), VI.-3:204 too will provide a platform for a claim for reparation for such losses. The same applies to the claim for compensation for the injury as such. The reparable nature of non-economic loss within a strict liability regime corresponds with the current position in the legal systems of most EU Member States.

No maximum limit to liability. VI.-3:204 likewise corresponds with the majority of the legal systems in the EU Member States in not proposing an upper limit to liability (cf. Council

Directive 85/374/EEC art. 16). Such limits are not an appropriate instrument to structure issues of strict liability, including product liability.

VI.-3:205: Accountability for damage caused by motor vehicles

(1) A keeper of a motor vehicle is accountable for the causation of personal injury and consequential loss, loss within VI.-2:202 (Loss suffered by third persons as a result of another's personal injury or death), and loss resulting from property damage (other than to the vehicle and its freight) in a traffic accident which results from the use of the vehicle.

(2) "Motor vehicle" means any vehicle intended for travel on land and propelled by mechanical power, but not running on rails, and any trailer, whether or not coupled.

COMMENTS

A. The concept of the rule

Formulation of the principle; no detailed rules. Liability for damage by motor vehicles is in many Member States the subject matter of an elaborate and detailed special regime of legislation, which for its part is flanked by a plethora of rules of the law on insurance, mainly indemnity insurance. The comprehensive legal matters which are the subject matter of this legislation did not lend themselves to being portrayed in detail in the context of these rules. On the other hand, the rules would have suffered from a considerable lacuna if they had remained silent on the law governing traffic accidents: traffic is still generally one of the most significant causes of damage. Therefore, this Article formulates the two principles crucial to the law on liability, but goes no further. These principles are: liability for personal injury and property damage caused by motor vehicles (i) is strict, and (ii) lies with the keeper of the vehicle. A strict liability for keepers of a motor vehicle is nowadays almost a common feature within Europe. In the few countries which do not provide for it, there are insurance solutions or a raising of the standard of care which in practice more or less produce the same outcome.

VI.-3:207(a) (Other accountability for the causation of legally relevant damage). The present Article must be read in conjunction with VI.-3:207 (Other accountability for the causation of legally relevant damage) sub-paragraph (a). This is because under the present Article there is liability only for motor-driven vehicles and not for other dangerous machines (e.g. a crane, or a concrete mixer or a shredder making tree branches into wood chips). These rules do not themselves propose strict liability for such machines and the same goes for vehicles like bicycles which are not motor-powered. The Member States' viewpoints are simply too far apart from each other to be able to devise an acceptable common proposal for all of these areas. These rules do not therefore contain the proposal to again forego the regime of liability already existing in the areas enumerated; through VI.-3:207 (Other accountability for the causation of legally relevant damage) the Group in fact clarifies that it could not arrive at a unified stance on these issues.

Insurance. Where insurance solutions *limit* the liability of the keeper (or any other person responsible for the damage caused), those rules will have priority by virtue of VI.-7:105 (Reduction or exclusion of liability to indemnified persons). Issues of direct liability of insurers or insurance funds are not the subject-matter of this Book. Issues of this kind belong in insurance law, not in the general law on non-contractual liability for damage. This follows indeed from VI.-1:101 (Basic rule). Solutions provided by insurance which operates independently of personal liability on the part of the keeper or the originator of the damage

(including insurance remedies which leave it up to the injured person to pursue rights against the insurer or against the injuring person) remain likewise unaffected. The same applies to claims against funds, in particular in cases in which the identity of the person causing the damage cannot be established due to the driver fleeing the scene of the accident. Both follow from VI.-1:103 (Scope of application) sub-paragraph (d).

Legally relevant damage. As with all the strict liability cases in Chapter 3, Section 2, the present Article relates only to personal injury and property damage. The specific risk which is of concern to the liability of keepers of motor vehicles only manifests itself in personal injury and property damage. For all other damage, only in the case of intention or negligence on the part of the person acting is the damage legally relevant and thus recoverable; the keeper *qua* keeper is not involved here.

Illustration 1

On the spur of the moment, a frustrated lover locks his girlfriend, who wants to break up with him, in the boot of an acquaintance's vehicle. The acquaintance is not responsible for the false imprisonment merely because he is the keeper of the vehicle.

Property damage. The damage caused due to the use of the motor vehicle must have been done to something other than the vehicle or its freight. In regard to damage to the vehicle itself there is no strict liability of the keeper vis-à-vis the owner of the vehicle. The liability of the keeper aims at protecting third persons and not the property interests of persons who have rights in the vehicle (e.g. a seller who has retained ownership of the vehicle until full payment of the price). Also excluded from the keeper's liability is any commercial freight transported using the vehicle. Damage to it is subject to a special regime of transport law. However, liability for property damage suffered by persons transported is included, e.g. damage to clothes or a mobile phone carried with them.

Personal injury. As regards personal injury, by contrast, there are no restrictions on the range of persons entitled to claim reparation. In particular, individuals are not deprived of the protection of this Article because they were passengers in the vehicle or driving it at the time. Persons who are active in the operation of the vehicle also have a claim in damages against the keeper in the case of personal injury.

Defences. The general defences in Chapter 5 also apply to the liability of keepers under VI.-3:205. However, VI.-5:102 (Contributory fault and accountability) paragraph (2)(c) deserves particular mention because under it, in road traffic cases, only considerable contributory fault (gross negligence) on the part of the victim is to be taken into account. The provision expressly relates only to personal and health injury.

B. Details

Motor vehicles and trailers. The Article, as mentioned, provides for strict liability to the detriment of keepers of motor vehicles. What "motor vehicles" are is defined by paragraph (2). That definition is in turn taken from Directive 72/166/EEC ([First] Directive on Insurance against Civil Liability in Respect of the Use of Motor Vehicles). The strict liability under VI.-3:205(1) thus relates to motor-driven vehicles of all types, including slow-moving vehicles (such as tractors, bicycles with an auxiliary motor, and sit-on lawnmowers, which, depending on their construction, may not be capable of more than 20 km/h). Trailers are also "motor vehicles" according to the Directive, even where they are not connected to the towing vehicle

at the time of the accident. Railway vehicles (including trams and underground railway), aeroplanes and ships are excluded; they are consistently subject to special regimes of liability, which remain unaffected by these rules (VI.–3:207 (Other accountability for the causation of legally relevant damage) sub-paragraph (a)).

Keeper. The term keeper in the context of this Article also follows from the general rules (see above comments under VI.–3:203 (Accountability for damage caused by animals)). Thieves and others who use the vehicle against the keeper’s will are themselves made keepers. However, the “real” keeper’s liability in negligence remains potentially applicable in such cases; it takes hold where the keeper in breach of duty omitted to reasonably secure the vehicle against unauthorised use.

No special liability for drivers. The Article channels the liability to the keeper (or the keeper’s insurer). In contrast, the liability of a driver who is not at the same time the keeper is subject to the general rules. In the case of professional drivers there may even be specific relief from liability provided for in the national legal systems, see VI.–7:104 (Liability of employees, employers, trade unions and employers’ associations) sub-paragraph (a). To subject private drivers to a particularly intensified liability (in the form of either strict liability or liability for presumed misconduct) seemed unreasonable against this background. The strict liability of the keeper, coupled with compulsory insurance and a direct claim against the insurer, suffices for the requirements of victim protection.

Traffic accident resulting from the use of the vehicle. Liability is confined to those *cases where the damage has been caused “in a traffic accident which results from the use of the vehicle”*. *Damage in connection with a parked car is therefore only within the scope of the Article if the vehicle has been parked on a road or area open to traffic or the public*. In other words, *the Article* relates only to situations in which the vehicle is used on a public road or on a road accessible to the public, and in which an “accident” in the sense of a sudden occurrence, typically a collision, occurs.

Illustration 2

X, renter and keeper of a tractor, drives home from a field with a trailer full of bales of hay. Not noticing that the hay has caught fire, he causes fire damage to the adjoining fields, which are likewise currently being harvested. X is liable due to a negligent breach of property rights, not however in his capacity as keeper of the tractor and trailer. A traffic accident is not at issue here.

Illustration 3

Someone illegally parked causes a traffic jam. This does not involve a traffic accident.

Causation. In relation to causation, the general rules in Chapter 4 apply. Thus, it must be possible to say of the relevant personal injury or property damage that it is to be regarded as a consequence of the use of the relevant vehicle, see VI.–4:101 (General rule). A vehicle properly parked at the side of the road is not to be regarded as the cause of the injury suffered when someone drives against this vehicle due to carelessness or drunkenness. The same applies to a car, which is at the front of a queue, into which the third person in the queue pushes the second vehicle. The use of the vehicle at the front did not cause the damage to the second and third vehicles. It is not sufficient that the vehicle (the parked car or vehicle number one) was “involved” in the accident; in fact it is decisive whether its use has caused the relevant accident within the meaning of VI.–4:101 (General rule).

Illustration 4

A collision between two vehicles occurs, leaving them stationary on the road with the consequence that a subsequent vehicle can no longer brake and drives into them. Here the person causing the first accident also caused the second accident.

VI.–3:206: Accountability for damage caused by dangerous substances or emissions

(1) A keeper of a substance or an operator of an installation is accountable for the causation by that substance or by emissions from that installation of personal injury and consequential loss, loss within VI.–2:202 (Loss suffered by third persons as a result of another’s personal injury or death), loss resulting from property damage, and burdens within VI.–2:209 (Burdens incurred by the State upon environmental impairment), if:

(a) having regard to their quantity and attributes, at the time of the emission, or, failing an emission, at the time of contact with the substance it is very likely that the substance or emission will cause such damage unless adequately controlled; and

(b) the damage results from the realisation of that danger.

(2) “Substance” includes chemicals (whether solid, liquid or gaseous). Microorganisms are to be treated like substances.

(3) “Emission” includes:

(a) the release or escape of substances;

(b) the conduction of electricity;

(c) heat, light and other radiation;

(d) noise and other vibrations; and

(e) other incorporeal impact on the environment.

(4) “Installation” includes a mobile installation and an installation under construction or not in use.

(5) However, a person is not accountable for the causation of damage under this Article if that person:

(a) does not keep the substance or operate the installation for purposes related to that person’s trade, business or profession; or

(b) shows that there was no failure to comply with statutory standards of control of the substance or management of the installation.

COMMENTS

A. A strict regime for environmental liability

Structure of the regime. This Article relates to liability for damage arising from dangerous substances or emissions. The provision establishes a strict environmental liability for businesses (paragraph (5)(a)). Paragraphs (1) and (5) clarify the ground of accountability, while paragraphs (2)–(4) add clarity as regards certain concepts which are invoked by paragraph (1): substance, emission, and installation.

Relationship to VI.–2:209 (Burdens incurred by the state upon environmental impairment). VI.–2:209 (Burdens incurred by the state upon environmental impairment) only regulates the question of what constitutes a legally relevant damage (of the state) in the circumstances set out there. It says nothing about the ground of liability or accountability. The

latter aspect, even in relation to the “pure ecological damage” detailed in VI.–2:209 (Burdens incurred by the state upon environmental impairment), is only taken up in the present Article.

Illustration 1

Cyanide which has been used in the process of extracting gold escapes from a gold mine. A river is polluted; an entire region suffers ecological damage. The State concerned may demand reparation from the business operating the mine by virtue of VI.–3:206 and, if the infringement of safety and maintenance rules can be established, VI.–2:209 (Burdens incurred by the state upon environmental impairment) in conjunction with VI.–3:102 (Negligence).

Legally relevant damage. Apart from this “pure ecological damage”, only injury to the body or health of an individual, detriments sustained by that individual’s relatives, and losses consequential to property damage are legally relevant in the context of the strict liability under the present Article. All other forms of damage are legally relevant only on the basis of liability for intention or negligence or in the context of national law (VI.–3:207 (Other accountability for the causation of legally relevant damage) sub-paragraph (b)). The contamination of land by emissions amounts to property damage sustained by the owner.

Illustration 2

Fluorine used in the processing of bauxite leaks from an aluminium plant. The toxic substance pollutes the surrounding agricultural estates, which as a result of the emission lose 90% of their earning potential. The company operating the plant is liable to the farmers for this damage independent of whether they can show that it was negligent in controlling the chemicals.

Illustration 3

Clouds of dark foul-smelling particles escape from a factory and settle on the roofs of houses in the locality. This is property damage for which there is strict liability under VI.–3:206.

Policy considerations. The Article is based on the observation that the predominant number by far of the EU Member States have shaped the core of environmental liability within private law – liability for injury to health and damage to property as a result of impairment of the ecosystem – in terms of strict liability. However, there still exist such substantial differences in detail between the national legal systems that it did not seem either sensible or indeed possible to formulate the rule in the manner of a proposal for maximum harmonisation. This Article therefore confines itself to expressing what, according to the appraisal of the comparative legal survey of the laws of the Member States, proved to be the “common denominator” of the preponderant number of the EU’s legal systems. Those marginal areas which do not lie within this intersection thus remain to be dealt with by reference to the applicable national law (VI.–3:207 (Other accountability for the causation of legally relevant damage) sub-paragraph (b)).

Illustration 4

A large accident occurs at a chemical plant, as a result of which steam containing dioxins is released into the atmosphere. The local population has to keep windows and doors closed and cannot leave their homes for 36 hours. Under these rules the restriction on freedom of movement for the individuals affected which has been caused by the air pollution is only a legally relevant damage (VI.–2:203 (Infringement

of dignity, liberty and privacy) paragraph (1)) if the operator of the chemical plant can be shown to have been negligent or if the applicable law provides for a strict liability for infringements of liberty.

Illustration 5

Following a fire at a business's warehouse, substances containing oil mix with the water used to extinguish the fire and flow into the nearby river. A few kilometres downstream company X operates open air swimming baths, which it is forced to close for several days. X sustains a loss of income, but no property damage. The question whether such a "pure economic loss" falls within the protection of a strict regime of environmental liability is determined exclusively by national law (VI.-3:207 (Other accountability for the causation of legally relevant damage)); under these rules X does not suffer legally relevant damage which is caught by the strict liability envisaged in VI.-3:206.

B. The persons liable

Keeper of a substance and operator of an installation. Liability under VI.-3:206 attaches to persons who independently exercise control over a substance or an installation, i.e. to the "keeper" of a substance and the "operator" of an installation. The "keeper" of a substance is liable for damage which is caused by the substance; the "operator" of an installation is liable for emissions. The concept of "keeper" follows the general rules. The term "operator" (*Betreiber*) designates the person (as a rule, a legal person) to whose business assets the installation belongs.

Private use excluded (paragraph (5)(a)). Liability does not arise under paragraph (1) if the relevant person does not keep the substance or operate the installation for purposes related to that person's trade, business or profession (paragraph (5)(a)). An owner-operator's private oil tank constitutes an "installation", but strict liability by reason of VI.-3:206 is not imposed on the owner-operator. Depending on their properties, pills and other medicines may be dangerous substances within the meaning of paragraph (1) and the same may be true of chemicals which are used for household cleaning or weed control. A general strict liability in such cases does not seem appropriate; it ought to arise only in respect of industrial production or commercial storage of these or similar chemicals, not least because in such cases entirely different quantities are involved. However, private individuals are subject to a particular duty of care if they possess or operate substances or installations of the type referred to in this Article. Moreover, the more dangerous a substance is, the more probable it is that there are prohibitions on private possession or at least public law rules to ensure the safe storage of such substances. The infringement of such rules is by itself negligence within the meaning of VI.-3:102 (Negligence) sub-paragraph (a). The same applies for the operation of installations with a potential environmental impact.

Other legal bases for a claim remain unaffected. Paragraph (5)(a) does not allow any room for doubt as to the fact that it is only liability "under *this* Article" which does not apply to private individuals. All other bases for a claim therefore remain unaffected. That applies not only to the claims just mentioned on the grounds of intention or negligence but also to claims for some other legal reason, e.g. property law claims between owners of neighbouring land (VI.-1:103 (Scope of application) sub-paragraph (d)) and claims based on public law duties to eliminate dangers to public safety.

C. The risk within the scope of the strict liability

Causation of damage by dangerous substances and emissions (paragraph (1)(a)). The potential danger which is intended to be covered by this Article is paraphrased in subparagraphs (a) and (b) of paragraph (1). Strict liability is not envisaged for every kind of substance or emission, but only for those which, viewed in the abstract, inherently pose a high risk for the environment (VI.–2:209 (Burdens incurred by the state upon environmental impairment)), for people and for property. The test question is whether it is “very likely” that the stored substance or emitted material will cause damage to health, property or the environment if it is not taken care of in an appropriate manner. Whether in an individual case appropriate care was in fact taken is not decisive; what is decisive is merely the fact that the dangerous characteristics of the substance or material make special precautions necessary. That is an objective test; the issue does not turn on the actual or constructive knowledge of the keeper or operator.

Dangerous quantity. The risk which is inherent in the relevant substance must be identified by having regard to the quantity and its specific characteristics. For example, water is, as such, completely harmless. However, when held in large volumes, it constitutes an obvious danger for people and property unless it is secured against leakage either above ground or subterraneously: a dam can burst and the base of a reservoir can be permeable. Even large quantities of grain or milk powder can be dangerous due to the risk of spontaneous combustion. Pure and therefore easily ignited alcohol can also be a dangerous substance if stored in larger quantities. If, on the other hand, it is merely used to disinfect a wound, liability under this Article can be excluded for several reasons.

Illustration 6

Doctors disinfect a patient prior to an operation, using chemicals containing alcohol. At the same time they use an electronic scalpel which produces a spark that ignites the alcohol in the chemicals. As a result the patient suffers severe burns. The liability of the hospital (VI.–3:201 (Accountability for damage caused by employees and representatives)) turns on the negligence of the doctors, not on the present Article. At the point in time that the injuries occurred, the hospital was not keeper of the chemicals; nor could it be said that it was “very probable” that “if not adequately controlled” those chemicals, in that small amount, would cause damage of that type. Nor is the electronic scalpel an “installation” within the meaning of this Article.

Relationship to VI.–3:202 (Accountability for damage caused by the unsafe state of an immovable). The relationship between this Article and VI.–3:202 (Accountability for damage caused by the unsafe state of an immovable) has already been explained in the comments on VI.–3:202. The rule in that Article embraces, for example, damage as a result of a burst water pipe. If, on the other hand, corrosive material is transported through a defective pipe, reparation for the damage will be recoverable on the basis of both provisions because the case involves a dangerous substance.

Dangerous attributes. Substances which pose a particular danger to persons and property due to their specific attributes are, for example, substances which ignite, explode or oxidise easily, poisonous and radiating materials of every sort and corrosive chemicals. Danger for the environment (though not necessarily for the health of individuals) is associated with, for example, genetically experimental breeding, but equally with mere liquid manure which is stored in the tanks of a large-scale agricultural concern. The number of dangerous substances is in fact so large that they cannot be exhaustively listed here. A good indicator of the dangerousness of a substance is the obligation to use hazard signs when transporting such

materials by road. Many European legal systems, moreover, have special regimes in which particular substances are characterised as dangerous for persons, property or the environment. This Article refers to such regulations implicitly.

Realisation of the risk establishing liability (paragraph (1)(b)). The strict liability for dangerous substances and emissions only arises if the damage results from the realisation of the risk which is specifically associated with the substance or emission. The danger which justifies a strict liability for the storage of a large volume of water in a reservoir is not that someone swimming in the reservoir might drown, but that the dam might burst and people or animals may be killed or injured as a result or that damage may be caused to premises in the neighbourhood.

Illustration 7

The owner of an estate constructs a water reservoir on his land. The contractor entrusted to undertake the work overlooks the fact that tunnels run under the reservoir, linking the land to a mine whose seams consequently fill up with water. The owner of the mine has a claim to reparation against the owner of the estate under this Article.

Causation. The damage must have been caused by the dangerous substance or emission. The test of causation is subject to the general rules of Chapter 4. Issues of the law of evidence and thus also questions of alleviation of the burden of proof (such as, for example, rules on *prima facie* evidence) remain matters for the law of evidence and procedure.

Illustration 8

A fish farming company loses a substantial part of its stock. The fish have been poisoned by substances which got into the ground with the effluent from X's plant and from there passed into the river whose waters transported the toxins into the company's breeding tanks. The death of the fish has been caused by the substances from X's plant. That the natural flow of the river has played a role in the causation of the damage does not detract from that.

Substance (paragraph (2)). The concept of 'substance' does not presuppose any particular physical condition. It may be solid, liquid or gaseous in form. The damage may be brought about by particles which are transported by the wind, by disposal of effluent, or by vapours. Micro-organisms as well as chemicals are substances. The former, however, are not animals within the meaning of VI.-3:203 (Accountability for damage caused by animals).

Emission (paragraph (3)). It follows from paragraphs (2) and (3) that the concept of an emission extends further than the concept of a substance. While substances (in whatever form) are also capable of being emitted, the notion of an emission equally embraces the conduct of electricity, heat, light and other radiation, noise and other vibrations and other incorporeal impact on the environment which is not referable to some substance. The concept of an emission always connotes a negative impact on the environment. In order to ascertain what is meant by "impact on the environment" in paragraph (3)(e) reference can be had to VI.-2:209 (Burdens incurred by the State upon environmental impairment).

Installation (paragraph (4)). Paragraph (4) extends the liability of the operator of an installation to its construction phase. The provision also makes it clear that the mere closure

of an installation will not preclude liability. In contrast to a “plant” an “installation” also embraces a mobile installation.

No failure to comply with statutory standards. Paragraph (5)(b) makes it possible for the potentially liable person to escape liability by proving that control of the substance was not defective or, as the case may be, that there was no mismanagement of the installation. That does not detract from the strict liability character of the rule because, as in the case of liability for products, only objectively defective control or management is in issue. However, such a provision is necessary – for example, in order to enable the operator of an installation to establish that the statutorily prescribed emission levels were not exceeded. Such statutory rules which lay down the extent of permitted emissions may be found in either Community law or national legal provisions.

Other defences. The defences in Chapter 5 are also applicable in the context of this Article. In particular VI.–5:302 (Event beyond control) is unaffected. In applying this provision, however, it is always necessary to assess whether it was really an external risk which materialised or whether, despite the influence of, for example, adverse weather conditions, it was in truth a risk on account of which the present Article envisages strict liability.

Illustration 9

In an agricultural concern rapeseed is sprayed with pesticides. As a result of torrential rainfall, the pesticide residues are transported on to neighbouring land where they cause the death of fish in a pond. The rain has not interrupted the chain of causation. It is not an event beyond control within the meaning of VI.–5:302 (Event beyond control), so as to excuse the farmer from liability. It does not excuse liability because it was the materialisation of a risk for which the farmer must bear responsibility under the present Article.

VI.–3:207: Other accountability for the causation of legally relevant damage

A person is also accountable for the causation of legally relevant damage if national law so provides where it:

- (a) relates to a source of danger which is not within VI.–3:104 (Accountability for damage caused by children or supervised persons) to VI.–3:205 (Accountability for damage caused by motor vehicles);*
- (b) relates to substances or emissions; or*
- (c) disapplies VI.–3:204 (Accountability for damage caused by defective products) paragraph (4)(e).*

COMMENTS

A. Policy considerations

Wide-ranging national law on strict liability; international treaties. The laws of the Member States on non-contractual liability for damage adopt differing standpoints on the issue of which matters should be the subject of accountability without intention or negligence. Hence the Articles under Chapter 3, Section 2 (Accountability without intention or negligence) which have so far been discussed only contain rules for those matters which according to the predominant European legal view ought to be subject to a regime of strict liability. Beyond this, matters must be left to the national legal systems. That is equally true

for the issues of liability which have already become the subject of international treaties unifying the law. Their myriad details and minutiae cannot be reproduced in model rules such as these. The rules could not address and do not aspire to address those matters of liability law which are unified by international treaty. A further consideration supporting this reticence is that for some matters, namely those of environmental liability law (e.g. in the area of oil pollution at sea) insurance and liability have been so closely tied up that a separate liability rule on these matters would not seem sound. In yet other areas of the law of reparation unified by international treaty the question may well be asked whether they actually form part of the law of non-contractual liability for damage. The law on the liability of innkeepers for things brought on to the premises is an example of that. In these rules this question is dealt with in Book IV, Part C in connection with contracts for storage (see IV.C.–5:110 (Liability of the hotel-keeper)).

Overview. This Article gives expression to the basic principle that a person is also accountable under these rules without intention or negligence if that person is subject to strict liability according to the applicable national law of a Member State. The word “also” makes it clear that one is concerned here with the causation of damage in circumstances in which there is no strict liability under VI.–3:201 to VI.–3:206. The relevant national non-contractual liability law must of course be applicable according to the private international law rules of the forum. That appeared so self-evident that it has not been mentioned expressly. On the other hand, it was necessary to spell out that the rules which this draft itself establishes for accountability without intention or negligence ought basically to be conclusive for the matters they address. Without this restriction it would be senseless to extend these rules to matters of strict liability. So the present Article circumscribes the referral to national law. It is only to be effective in three groups of cases, namely (i) where it is the realisation of a source of danger which is not already covered by VI.–3:104 (Accountability for damage caused by children or supervised persons) to VI.–3:205 (Accountability for damage caused by motor vehicles) which is at stake, (ii) where questions of environmental liability law are concerned, and (iii) where national product liability law recognises strict liability for development risks.

Legally relevant damage; national law. The provisions of Chapter 2 determine what is to be understood as a legally relevant damage in the context of this Article. The referral to “national” law includes a referral to national implementations of internationally unified liability law since international treaties as such bind the ratifying states. National implementation of Directives of the European Community are also “national law”.

B. Details

Sub-paragraph (a). The rules in VI.–3:104 (Accountability for damage caused by children or supervised persons) are also conceived as being exhaustive for their field of application. In other words these rules adopt the position that there is to be no strict liability of parents (VI.–3:104(3)). They do not regard the fact that people have children as being a sufficient ground of liability. The reference to VI.–3:201 (Accountability for damage caused by employees and representatives) has the effect, for example, that there can be no going behind the proposition implied there which rules out a strict liability for the conduct of employees who cause damage other than “in the course of their employment”. It follows from the references to VI.–3:202 to VI.–3:205 that the strict liability set out there may not be extended to damage which is only legally relevant in cases of intention or negligence.

Examples. Dangers which are *not* addressed by the Articles referred to in paragraph (a) include, for example, the danger envisaged by the rule in Council Directive 2004/113/EC of

13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods (OJ L 373/37 of 21 December 2004). The Directive makes provision regarding unwanted conduct related to the sex of a person with the purpose *or effect* of violating the dignity of a person (Art. 2(c)). VI.–3:207 sub-paragraph (a) also embraces those cases in which the liable person (from a purely objective point of view) has infringed a statute which requires compliance with a certain standard of safety (e.g. in respect of safety of machinery in a factory) independent of any considerations as to want of care, and liability for the accident turns only on the fact that the required measure of safety was not in place. “Breach of statutory duty” in this specific sense is not negligence, but rather a form of strict liability. The source of danger which is at issue in VI.–3:201 (Accountability for damage caused by employees and representatives) is labour under the control of the person accountable. Consequently there remains scope under sub-paragraph (a) of the present Article for a strict liability for independent contractors or sub-contractors and for mere casual helpers. Similarly VI.–3:205 (Accountability for damage caused by motor vehicles) relates to the dangers arising from motor vehicles but is silent as regards other dangerous vehicles and machines (e.g. a crane, or a concrete mixer or a shredder making wood chips out of tree branches). Railways, aircraft and watercraft are expressly excluded from the scope of that Article by its second paragraph. Consequently the present Article creates scope for strict liability in those fields under the applicable national law. That applies even for movables which cannot even be described as a “machine” (e.g. weapons of all sorts) and it applies also for movables which are not inherently dangerous (such as, for example, bicycles, tables or items of sports equipment).

Sub-paragraph (b). There is also broad scope for supplementary strict liability under national law by virtue of sub-paragraph (b). The provision gives expression to the proposition that VI.–3:206 (Accountability for damage caused by dangerous substances or emissions) only covers the core component of rules on environmental liability. Beyond that core it neither intrudes into special regimes (nuclear civil liability, oil pollution at sea, etc) nor purports to develop a conclusive set of rules for legally relevant damage in the context of liability without intention or negligence.

Sub-paragraph (c). Finally, sub-paragraph (c) translates into the language of these rules the principle in Council Directive 85/374/EEC art. 15(1)(b): see comments under VI.–3:204 (Accountability for damage caused by defective products).

VI.–3:208: Abandonment

For the purposes of this Section, a person remains accountable for an immovable, vehicle, substance or installation which that person abandons until another exercises independent control over it or becomes its keeper or operator. This applies correspondingly, so far as reasonable, in respect of a keeper of an animal.

COMMENTS

A. First sentence

Purpose of the rule. This Article adds a clarification for the purposes of VI.–3:202 (Accountability for damage caused by the unsafe state of an immovable), VI.–3:203 (Accountability for damage caused by animals), VI.–3:205 (Accountability for damage

caused by motor vehicles) and VI.-3:206 (Accountability for damage caused by dangerous substances or emissions). The point in time for which status as owner, keeper or occupier is material is essentially the moment when the event causing the damage occurs. This Article makes an exception to that basic rule. No-one should be able to avoid responsibility as owner, keeper or occupier simply by abandonment.

Abandonment. “Abandonment” presupposes an intentional and voluntary act which is directed towards giving up control of the thing. The unintended loss of a thing is not an abandonment. Nor is there an abandonment when another’s property is returned properly, e.g. when a motor vehicle is parked by its temporary keeper at a given car park, as agreed with the owner, in order that the latter can drive it away from there later. Equally the correct disposal of a thing or substance is not an abandonment because in such a case the thing or substance passes without hiatus into another’s control. By contrast, a person who simply leaves an old, but still fully functional, vehicle at the side of the road or lets an installation or plant become derelict without taking measures to safeguard it or who tips dangerous substances on to a rubbish dump, buries them somewhere in the countryside or lets them sink into a pond, remains responsible for that thing, even if no longer its keeper at this point in time.

B. Second sentence

Animals. The same starting point applies also to animals, but requires qualification by a reasonableness test. This is necessary to take account, for example, of wild animals which have been raised in captivity, but with a view to their reintroduction into the wild, and animals which have run away and can no longer be recaptured.

CHAPTER 4: CAUSATION

VI.-4:101: General rule

(1) A person causes legally relevant damage to another if the damage is to be regarded as a consequence of:

(a) that person’s conduct; or

(b) a source of danger for which that person is responsible.

(2) In cases of personal injury or death the injured person’s predisposition with respect to the type or extent of the injury sustained is to be disregarded.

COMMENTS

A. General

Scope. Paragraph (1) contains a general rule on causation. It relates to both the causation of damage by human conduct and the causation of damage in cases in which the ground of accountability is not human conduct, but rather a person’s responsibility for a source of danger. In the latter case the legally relevant damage must have been caused by the source of danger. The Article is linked to VI.-1:101 (Basic rule) paragraph (1), under which causation

constitutes one of the three indispensable pillars for liability under this Book (alongside legally relevant damage and accountability). Paragraph (2) of the present Article contains a special rule for the case of the injury or death of a person who already, prior to the accident, suffered from an infirmity or illness which contributed to the severity of the physical injury.

Policy considerations. Notwithstanding the many questions connected with the concept of causation, it is an undisputed cornerstone of all European legal systems of liability - including Community law - that the legally relevant damage must have been “caused” either by the liable person or by another person or a material source of danger for which that person bears responsibility. Although causation alone is never sufficient for liability - apart from some regional exceptions in the law on traffic accidents - civil liability in damages never comes into the picture without it. This branch of the law does not impose liability for damages simply for moral or general political reasons. It is not the “duty defaulter”, the “rich person” or the “insured party” who is made liable, but rather a person to whose sphere of control the subsequent mishap may be traced back. Where sufficient evidence of this causal link is lacking, while a person may be exposed to responsibility under criminal or insurance law or may incur other sanctions, there is no liability under this branch of the law. In the Europe of today, a mere attempt to harm no longer grounds civil liability in damages in any jurisdiction. Wrongful conduct that is apt to occasion damage, but has not yet done so, may, however, be prevented by means of a prior restraint order (VI.–1:102 (Prevention)).

Illustration 1

A claim in damages does not materialise where the dishonest competitive conduct of A did not cause the subsequent loss of profit of competitor B, because the lost profit had been attributable to a dip in sales due to a slow-down in the economy. B can, however, obtain protection from further dishonest anti-competitive behaviour on A’s part where there is a threat of a further setback in profits because of it.

The term causation. The term “causation” is used in all European systems of legal liability, but is nowhere defined. Provisions giving some indication of how causation is to be *determined* are encountered, but only infrequently. As can be seen from this Article and from VI.–1:101 (Basic rule), this Book regards causation as the necessary link between (a) the intentional or negligent conduct of the person who is to be held liable or a source of danger for which that person bears responsibility and (b) legally relevant damage. It must be possible to say of the damage that it is to be regarded as a consequence of the liable person’s conduct or of a source of danger for which that person is responsible. The Article builds on Chapters 2 and 3 and makes it clear that causation can follow differently nuanced rules depending on the attributive cause and the legally relevant damage.

Causation by conduct. Paragraph (1)(a) governs the case in which a person has caused the relevant damage by that person’s own conduct. “Conduct” has the same meaning here as in the context of VI.–3:102 (Negligence). See the comments on that provision.

Causation by omission. The Article makes no distinction between positive action on the one hand and passivity or omission on the other. The cause of legally relevant damage as a matter of law under these rules may well be an omission. This follows the pattern set in the context of negligence, where the draft also avoids differentiating between positive acts and omissions (see comments to VI.–3:102 (Negligence)). It would contradict that approach to adopt a different line in relation to causation. The only possibility for a precise separation of positive acts from omissions would presumably be a test of whether a person had physically acted or not. Such a criterion is, however, not legally usable. For example, a driver who fails to stop at a red light and consequently injures a passenger would have to be regarded as having omitted

to act (by omitting to remove the foot from the accelerator and apply it to the brake pedal) rather than as having positively done something which ought not to have been done. That would scarcely be in line with normal conceptions of the basis of liability. An omission by a person is a cause of damage when (a) the person had the opportunity to intervene and was under a duty to use that opportunity and (b) the damage is to be regarded as a consequence of the failure to intervene.

Illustration 2

A doctor fails to tell the hospital of a patient's high risk of suicide. However, the hospital was already aware of this danger. The omission to inform was thus not causative of the death of the patient.

Illustration 3

Two acquaintances go fishing together. For that they use electric power – as they have done on previous occasions – which one of them (A) feeds into the river with the aid of an insulated cable from a public power supply line, while from the riverbank the other (B) drags a long wooden rod with a wire net on it through the water. B suddenly falls into the river. A sets about getting him out of the water but abandons his attempt when he feels the electricity in the water. First of all, he disconnects the cable from the supply line, which costs him a lot of time. B's deceased body is later taken from the water. It turns out that he was already dead when he fell into the water. The cause of B's death was not A's omission to rescue him, but a circulatory failure (resulting from a so-called stance tension caused by the splay of his legs while fishing). Conversely, while A's joint action with B in relation to the fishing was indeed causative of B's death, the latter acted at his own risk when he got involved in such a dangerous activity (VI.-5:101(2) (Consent and acting at own risk)).

Causation by a source of danger. Chapter 3, Section 2 (Accountability without intention or negligence) sets out the situations in which a person is liable although that person may have behaved entirely correctly and not caused the damage by conduct. While in these cases liability also requires causation, the damage will not have been caused by the person liable. Precisely because this is so, in most cases of this nature it is only the causing of particular types of damage which will lead to liability. In other words, in the context of this type of attributive cause, only certain types of damage are legally relevant. Two basic situations must be distinguished.

Vicarious liability. In the first group of cases – often and imprecisely termed “vicarious liability” – the damage has been caused by a person for whom the person liable must take responsibility. The main example is to be found in VI.-3:201 (Accountability for damage caused by employees and representatives). The damage is actually caused by, for example, the employee and not the employer. The mere hiring of an employee is insufficient to qualify as a cause of damage because such conduct is allowed and even desired. (It would be different where the employee is hired for a job which is manifestly beyond the employee's capabilities; here the employer is acting in breach of duty). In contrast, the case of a parent's liability (VI.-3:104 (Accountability for damage caused by children or supervised persons)) has to do with a double test of causation because the wrongdoing of the child as well as the parent's failure to supervise will be causative of the damage.

Damage caused by animals and things. In the second group of cases the damage has been caused by the realisation of a danger from a source for which the liable person is responsible. The text does not therefore proceed from the proposition that only humans are capable of being the “cause” of damage. Rather the cause of a legally relevant damage might equally be

an animal, the condition of land or premises, motor vehicles, products, substances or the like. In such cases the rules set out in VI.-4:103 (Alternative causes) might also apply.

Connection between legally relevant damage, attributive cause and causation. Paragraph (1) of the Article sets out the connecting link – necessary for the law on liability - between legally relevant damage and attributive cause (intention, negligence, source of risk). The formulation has been deliberately kept flexible (“is *to be regarded* as a consequence...”) so as to ensure that, in the context of causation, differences between individual attributive causes and legally relevant damage can be taken into account. In a legal setting there is no “one-size-fits-all” general test for causation. Rather, considerations relevant to causation may be different depending on which ground of liability and which kind of legally relevant damage is in focus. If the person causing the damage has acted intentionally, it will be easier to characterise a legally relevant damage as the consequence of the conduct than if the matter is one of misjudgement or minor carelessness. Similarly, if the damage takes the form of personal injury, causation may be more readily affirmed than would be the case with damage to property or a pure economic loss. For the cases of liability without intention or negligence the provisions of Chapter 3, Section 2 contain specific rules which are also important for the test for causation. This is because their underlying feature is that liability depends on whether the risk which justifies the imposition of the strict liability is realised in the damage which has occurred.

Special rules. A few special rules supplement the general rule in paragraph (1) of the Article. Paragraph (2) expresses the idea that a wrongdoer “must take his victim as he finds him”, thus precluding the argument that the injury is in reality attributable to a condition or affliction from which the victim already suffered and not to the conduct of the wrongdoer. VI.-4:102 (Collaboration) may be regarded as a rule which clarifies in a specific case the application of the doctrine of “psychological” causation. VI.-4:103 (Alternative causes) governs the special case of so-called “alternative” causation. In contrast, VI.-6:103 (Equalisation of benefits) proceeds on the basis that issues of so-called benefit equalisation are not to be qualified as a matter of causation, but as a question of the extent of the reparation which is to be provided. However, there is no provision in this Book which would render the members of a group (e.g. participants in a protest march willing to resort to violence) liable solely because of their participation in the activities of the group. Incidentally, that would also be a rule which would have to be conceived as a norm of accountability (liability for the causation of legally relevant damage by others), not of causation. The question of liability for loss of a chance would be a question concerning legally relevant damage, not causation; of course the differences of opinion on this issue confirm that these two elements of liability (legally relevant damage and causation) partially intersect.

B. Particulars

Cause in fact and cause in law not distinguished. Many jurists are inclined to make questions of causation the subject of fundamental and philosophically elevated treatment. It is not the function of paragraph (1) of this Article to attach itself firmly to a defined theoretical position within the broad spectrum of opinion. The width and complexity of the subject do not speak in favour of a precise rule on causation. Paragraph (1) therefore only establishes the basic principle on which all juristic considerations of causation rest: a conduct or a source of danger causes a legally relevant damage if the damage is to be regarded as a consequence of that conduct or source of danger. Consequently, the provision does not distinguish between a cause in fact and a cause in law. The Article rather leaves it for further discussion whether and

to what extent such a distinction will stand up in theory and in turn lend itself to being put into practice.

No reduction to a “*conditio sine qua non*” formula. This is in turn the reason why paragraph (1) does not reduce the test for causation to a “but for” or “*conditio sine qua non*” test. This would have merely put a “factual” or “scientific” concept of causation into words. Numerous exceptions and expansions would have been necessary, even at this level, without there being any real prospect of exhaustively covering the subject-matter. Just as important is the point that the “but for” test alone cannot separate consequences falling within the perimeter of relevant liability from consequences falling outside this perimeter and not giving rise to liability. This process of separation takes place well-nigh unavoidably on the basis of a value judgement, of what might be called a “legal” or “normative” test for causation. Incidentally, in the context of these rules, the decisive factor is not whether a random event is the cause of another random event, but rather whether there is a link of cause and effect between an intentional or negligent conduct or a source of danger on the one hand and a legally relevant damage on the other. The jurist does not ask the question e.g. whether someone who gets up in the morning five minutes earlier and was therefore earlier at the scene of the accident has caused the accident solely by virtue of this fact, because the very breach of duty is already lacking. The question would be just as pointless as the question whether a person injured by an assault caused the injury through mere presence at the site of the incident.

Illustration 4

An accident occurs on a straight road. Through lack of attention, A drives into B’s car, which is at the side of the road fully in accordance with traffic regulations. Neither the damage to B’s vehicle nor the damage to A’s car is the consequence of negligent conduct on the part of B; nor are they a consequence of the use of B’s car.

Elements of assessment. The factors to be taken into account in deciding whether a particular legally relevant damage is to be seen as a consequence (even if it is not the only one) of particular wrongdoing or of a particular source of danger do not lend themselves well to being conclusively listed nor to being given a relative weighting in relation to each other. Each individual case can make a new calibration necessary. Aspects of probability and foreseeability come into play but so too do the type of the attributive cause and the type of damage. Also relevant are the protective aim of the norm of social behaviour which has been infringed and (occasionally) general policy considerations. In European legal doctrine there are numerous formulations on this topic – for instance that the damage arising must be an “adequate” consequence of the act breaching a duty, that it may not be “too remote” or that through it, an individually specified risk must have been realised. These doctrinal approaches are neither confirmed nor challenged by the Article.

Break in the chain of causation. Only through carefully evaluated considerations of the type mentioned may a solution be found to questions like whether the damage incurred is to be deemed a consequence of a particular person’s conduct or whether it is to be attributed in whole or in part to the conduct of an intervening third party or even to the conduct of the victim. While the intentional intervention of a third party typically breaks the chain of causation or liability, it depends on the circumstances of each individual case whether or not the damage is to be seen as a consequence of a particular person’s conduct.

Illustration 5

While having a rest, a hunter (A) leaves a loaded rifle leaning against a tree contrary to regulations. B lifts the rifle; it lets off a shot and C is killed. A’s conduct in breach of duty was causative for the death of C if the shot went off by accident when B was

holding the rifle or if B indeed intended to fire the rifle and then mistakenly hit C. In contrast, C's death can no longer be seen as a consequence of A's not unloading the weapon if B took the rifle for the purpose of killing C, unless A had set up the scenario in order to facilitate this deed.

Illustration 6

A is responsible for a road accident. The scene of the accident must be closed off for a spell. Impatient drivers drive around the accident scene and so damage the bordering cycle lanes and pedestrian pathways. This is no longer a consequence of A's wrongdoing, through which the road accident occurred.

Illustration 7

A and her life partner B are accosted by D and E when leaving C's discotheque. After an exchange of words between C and D, B is beaten up. A attempts to get help but is then struck herself by E and severely injured. C (who is sued by A because he alone has a deep pocket) is also liable to A for her damage. The intervention of E does not break the chain of causation because life experience shows that when someone out of a group begins a brawl, it easily leads to uncontrollable complications.

Self-harm of the victim; contributory fault. Where the intervening person is later the victim, two questions must be kept apart. The first question is always whether the person alleged to be liable also caused (along with the victim) the victim's conduct and subsequent damage. This is typically answered in the affirmative if the victim's act or omission was provoked by the person's wrongdoing, i.e. where it was probable that the victim would react in this way. Only when this question has been answered in the affirmative does the further question arise whether the injured person's right to compensation under VI.-5:102 (Contributory fault and accountability) is to be reduced because of contributory fault.

Illustration 8

A suffers a head injury in a traffic accident and then develops a tendency to attack women. He is rendered liable in damages to the women and demands compensation from B, who was responsible for the traffic accident. However, the liabilities to pay damages are not to be regarded as a consequence of the accident; they are to be regarded as the consequences of A's own criminal acts.

Illustration 9

In the course of an operation, A's daughter's only kidney is culpably removed; A's mother then decides to donate one of her kidneys. An easily understandable and obvious decision is what is at issue here; consequently, the doctor is liable as against the mother.

Illustration 10

Following the theft of several vehicles and their retrieval, an insurance company pays a finder's reward. The vehicle thief must compensate the insurance company for this because even the insured party, whose claims to insurance were passed over, would have had to pay a finder's reward. The latter is a consequence of the theft.

Illustration 11

A tram driver is stopped by an inspector and summoned to pay a fine. The driver jumps up and runs through the opening door of a train just arriving at the stop. The inspector follows, falls and breaks a leg. This is still deemed a consequence of the conduct of the tram driver, unless the tram driver did not know of the pursuit and would have had no reason to infer this.

Causation of a legally relevant damage. The Article is concerned with the causation of legally relevant damage. What exactly constitutes a legally relevant damage is determined by Chapter 2. It may take the form of a mere injury, but equally it may consist in a particular loss. In the latter case, strictly considered, there are two issues of causation in the majority of

cases. In a case involving VI.–2:206 (Loss upon infringement of property or lawful possession), for example, the conduct must have caused physical damage to the thing and that in turn must have resulted in a loss. However, the considerations as a legal matter of causation are in the two cases fundamentally the same. The same arguments apply in relation to those provisions in Chapter 2 which refer to a loss arising “as a result” of a given injury, infringement of a right or physical damage.

Burden of proof. In this context, the decisive element is the determination that the legally relevant damage suffered is to be deemed a consequence of a person’s conduct or the realisation of a source of risk, for which a person bears responsibility. Therefore, under paragraph (1) there is no room for specific provisions on the burden of proof, and particularly no room for the reversal of the burden of proof in special situations. After all the relevant circumstances have been weighed up in an individual case, the conclusion that the damage is to be deemed a consequence of the relevant conduct or source of danger is based on a legal assessment. If the matter goes to court, the judge is afforded a certain amount of discretion which may and must be exercised. The facts upon which a judgment will be based are to be proven by the claimant according to general provisions (possibly including the *res ipsa loquitur* rule, depending on the applicable law of evidence). Whether the existence of a cause-and-effect relationship between the wrongdoing and damage can be drawn from them, is not something which seems to be amenable to the allocation of the burden of proof. Particularly in the frequently very complex situations of cause and effect with which the law on liability for environmental pollution has to struggle, the assessment of causation must be undisturbed in relation to probability assessment. Where for instance rays of a certain kind very frequently lead to a cancerous disease of the relevant kind and the victim lives in the vicinity of the emitting entity and belongs to a special risk group, there is no reasonable ground for the inference that the disease is not a consequence of the rays.

“Egg shell skull” (paragraph (2)). Under paragraph (2), in cases of personal injury or death, the injured person’s predisposition with respect to the type or extent of the injury sustained is to be disregarded. In principle, any person who injures another should not be exonerated because the victim’s health was previously unsound or because the victim suffered from a physical or mental affliction. Injury to body or health, and death, in cases caught by paragraph (2) in conjunction with paragraph (1) must be seen as a consequence of the relevant conduct. A person who injures a victim in weak health cannot demand to be put in the position which would have existed if the victim had been healthy; also, in cases of psychological injury, the injury is in principle attributable to the person who inflicted the injury despite the injured person’s particular vulnerability. However, depending on the situation in each case, it is conceivable that some pre-existing harm might be regarded as relevant to a reduction of the amount of compensation owed.

Illustration 12

Following an accident for which X is responsible, malignant tumour tissue in the victim’s head is torn open and she dies three weeks later. Her hitherto unknown cancerous disease would have ended fatally in any event. However, the accident sped up the process; as a result, the death was a consequence of the accident. The compensation due to dependants for lost maintenance (VI.–2:202 (Loss suffered by third persons as a result of another’s personal injury or death) paragraph (2)(c)) is limited to the period of time the victim would have probably lived had it not been for the accident. When calculating the non-economic losses suffered by third persons as a result of the death, the pre-existing cancerous disease is also to be taken into account.

Illustration 13

As a result of the severe injury of both parents, a child suffers nervous shock, requiring medical treatment. The fact that the child had a pre-existing illness and even a hereditary affliction changes nothing *vis à vis* causation.

VI.-4:102: Collaboration

A person who participates with, instigates or materially assists another in causing legally relevant damage is to be regarded as causing that damage.

COMMENTS

Purpose. This Article establishes the rule that persons who collaborate in causing legally relevant damage are to be regarded as causing the damage. Normally the question at issue here is liability for intention – on the part of the main actor and the persons with a contributory role. In cases of liability without intention or negligence collaboration is not conceivable. That is because in those cases no conduct of the liable person is required. In cases of instigation or assistance, all parties act intentionally. Where accomplices are involved, it is conceivable that as a consequence of an intentional antecedent wrong, merely negligent consequential harm then comes about, for which all accomplices are solidarily liable, even where their participation was not active. Several thieves can also become collective holders of a stolen vehicle; they are already liable under VI.-3:205 (Accountability for damage caused by motor vehicles).

Illustration 1

A, B and C have stolen a car and wish to bring it to a safe place. A sits at the wheel, B in the passenger seat and C in the back seat. Through a driving error during the nervous getaway, A causes damage to the car or to property belonging to a third party. B and C are also liable for this because the theft and getaway rested upon a common resolution of intent and a common plan. This liability results from the present Article. Liability as holder of the vehicle under VI.-3:205 (Accountability for damage caused by motor vehicles) remains unaffected.

Scope. This Article relates to the causation of damage by participants, instigators and accessories or aiders. It concerns situations which may be described as ones of “psychological causation”. This is because the issue here is responsibility for having either brought about the resolution of intent of the person acting directly or having spurred that person on in the relevant conduct. Since all three classes of persons are treated alike, no precise differentiation among them is required. Hence the wording of the rule deliberately avoids the use of terminology from criminal law.

Relation to VI.-4:103 (Alternative causes). The present Article requires a conscious and wilful co-operation of the participant in the causation of damage. If this is present every person acting causes the damage. In contrast, VI.-4:103 (Alternative causes) deals with cases in which multiple occurrences are possible alternative causes of the damage – where, in other words, it is an open question whether one person or another has caused the damage but where it is clear that either the one or the other caused it. Where a case falls under VI.-4:102, there is consequently no room for the application of VI.-4:103; this is because under the former Article it is already given that *each* collaborator is regarded as causing the damage. Moreover, VI.-4:103 may also come into play in cases of strict liability, whereas VI.-4:102 presupposes a liability for some misconduct.

Relation to VI.–6:105 (Solidary liability). VI.–4:102 must be read in conjunction with VI.–6:105 (Solidary liability). Participants, instigators and accessories are solidarily liable with the (principal) wrongdoer.

Illustration 2

At a public meeting, a son reads the text of a speech drafted by his father, which contains serious defamatory attacks on the personal and professional reputation of another. The media report on this event and on the defamatory allegations made in the speech. Both father and son are looked upon as the cause of the third party's damage; they are solidarily liable.

Illustration 3

A, B, C and D had drawn up a plan to poach X's customers through the provision of false information on X's supposed infringements of copyright law. A drafts and (alone) signs the relevant letter. B, C and D have also caused X's damage (see VI.–2:208 (Loss upon unlawful impairment of business)).

Collaboration. VI.–4:102 only relates to cases in which several persons collaborate to cause one and the same damage. This applies e.g. to the thief and the receiver of stolen goods in relation to the owner. Conversely, where collaboration is absent, the case is then one of so-called *concurrent wrongdoers*. Such persons, who act independently of each other or are independently responsible for different sources of danger, are solidarily liable under VI.–6:105 (Solidary liability) where the same damage is attributable to each of them, for instance, where liability results from the positive act of one party and the omission of another or where an employee is liable for intentionally inflicted damage and he employer is subject to strict liability for the same damage.

Members of a group. During the preparation of this Book, intense discussion took place on the issue of whether a further rule should be adopted in addition to this Article. Under this mooted rule, where a member of a group intentionally causes a third party a legally relevant damage, other members of that group would be liable for the damage in so far as the risk of intentional occurrence of damage of that type was foreseeable and those members should have abstained from participating in the group. It was also discussed whether this liability should rest only upon those who were present at the scene of the wrong and whether their liability should only come into play in a subsidiary fashion. This suggestion was, however, rejected as being too far-reaching. The main objection was that such a rule, which would forego the requirement of collaboration and would be based solely upon "membership" in a group, would not be capable of being brought into harmony with the freedom to demonstrate.

Participants. "Participants" in the sense of the Article are those persons who either play a part in carrying out an overall plan (one person breaks into a house in order to make away with items from it, the other stands at the door and keeps a look out or waits in the getaway car), or persons who indeed do not participate in the actual act of wrongdoing themselves, and yet stay "in the background" maintaining command or co-command over the course of events. Injurious conduct of the primary acting party going beyond the original common plan will be attributed to them as a consequence of their own participation in the act, unless there are extraordinary circumstances.

Instigators. Instigators cannot make the excuse that the acting party wished to carry out the act and did so intentionally. Rather, the Article makes it clear that this does *not* break the chain of cause and effect between the incitement and the legally relevant damage. The decisive point is that the instigator has provided the party acting with an additional reason to take action. It is not necessary that the instigator was the person who first put the idea into the acting party's mind.

Illustration 4

Students have occupied an empty house in order to draw attention to what in their view are indefensible machinations of local property dealers, who are apparently raising the price of property by reducing the availability of accommodation. The police attempt to clear the property and an affray with the students breaks out on the ground floor. On the floor above other students call out heated encouragement to their colleagues below. The students in the upper storey have caused damage to the police officers even if the students below would have initiated the affray without their calls to arms. On the other hand the students in the upper storey are not causally connected if, in the tumult below, their encouragement could not be heard.

Accessories. Accessories or aiders support the person acting directly in carrying out the act, but have no influence over whether it actually comes about or not. The requirement is that the aider knows of the general outline of the primary act and wishes to assist in it. There is no negligent assistance; the same goes for assistance with a negligent act.

VI.-4:103: Alternative causes

Where legally relevant damage may have been caused by any one or more of a number of occurrences for which different persons are accountable and it is established that the damage was caused by one of these occurrences but not which one, each person who is accountable for any of the occurrences is rebuttably presumed to have caused that damage.

COMMENTS

Loosening requirements for establishing the chain of cause and effect. The aim of this Article is to facilitate the establishment of a causal link between legally relevant damage and conduct in breach of duty or flowing from a source of danger even in certain cases where such a link would have to be denied under VI.-4:101 (General rule) paragraph (1) or under VI.-4:102 (Collaboration). Where under the rule in VI.-4:101(1), a legally relevant damage is to be seen as the consequence of *either* the wrongdoing (etc.) of A *or* the wrongdoing of B (or of C, etc.) but it is not possible to conclusively say that it was the consequence of A's behaviour or of B's behaviour, the effect of the present Article is that the damage is presumed to be the consequence of the conduct of A *as well as* of B (and of C etc.). Each is free, however, to prove facts from which it may be gathered under VI.-4:101(1) that his or her conduct in breach of duty was not part of the causal chain.

Policy considerations. Such a special rule requires justification. This is to be found in a general consideration of justice. A person who breaches a duty owed to the injured person or exposes that person to a greater risk should not be exonerated from liability solely because another person also breached a duty owed to the injured person and it is no longer possible to

say which of the breaches of duty caused the damage. The corresponding risk of inexplicability must be borne by those in breach of duty and not by the injured person.

Illustration 1

Solidary liability falls on the operators of two mountain coal-mines, in which the injured person worked under conditions of exposure to an unreasonably high health risk; even if it can no longer be determined in which of the two work places the person contracted the illness. The position would be different if a social insurance scheme for accidents at work provided a different solution for such cases (VI.-1:103 (Scope of application) and VI.-7:104 (Liability of employees, employers, trade unions and employers' associations)).

General requirements. The Article aims to relieve the victim of an undue necessity to prove facts from which a court, under VI.-4:101 (General rule) paragraph (1), would have drawn the conclusion that the legally relevant damage suffered by the victim is to be regarded as a consequence of a particular person's intentional or negligent conduct (or a source of danger for which that person is responsible). It is not intended to do more. The victim must therefore, as before, prove the existence of a legally relevant damage and that the other person would be liable for the damage suffered if the causality of that person's contribution is supposed. The victim must also establish that the other person belongs to that circle of persons of whom it can be said with certainty that one caused the damage. On the other hand the Article is not intended to provide the victim with an additional person against whom a claim can be made. If it is clear that a particular person is fully responsible for the damage, but that person is not financially capable of making full reparation, there is no reason why the victim should have the windfall benefit of other persons to sue. The same holds true where it is clear that two persons have respectively caused different damage.

Illustration 2

In a traffic accident, for which T is responsible, O is thrown from a bicycle on to the tarmac. T stops, but is not able to prevent a following vehicle (driven by F) from hitting O. It is not clear which injuries O had sustained before the second collision. T is liable for the full damage because T's conduct was causal in relation to the subsequent accident and the injuries it entailed. F is not liable for the full damage; but is at most liable for a share of the damage to be assessed on the basis of the rules of civil procedure. (If no such assessment is possible, F is not liable at all.) The situation would not be different if T failed to stop and left the scene unidentified. As regards the share for which F is liable, T and F are solidary debtors. The case is not one for the application of VI.-4:103.

Illustration 3

An employee A suffers a lung disease. It is not clear whether this disease is triggered by a single proximate exposure to a particular chemical or an accumulation of such exposures. Successive employers of A in breach of their duty failed to protect A from the hazard posed by this chemical. It is therefore uncertain whether only one (and, if so, which one) of these breaches of duty has caused A's damage or whether both have. The causation by each of these breaches of duty is presumed; VI.-4:103 dispenses with A's difficulties of proof.

Illustration 4:

Two hunters discharge their weapons at the same time and in the same direction. A third party is hit and injured, once in the left leg and once in the right. Weapons

specialists can say, however, from which weapon each relevant shot was fired. Each hunter is liable solely for the consequences of his shot; the case does not fall under VI.–4:103. It would be different where the victim had only been injured by one shot, and it could no longer be established from which of the weapons the shot in question had come.

Different persons must be accountable. In relation to the claimant’s legally relevant damage, the Article requires that the various parties fulfill the requisites of liability of VI.–1:101 (Basic rule) (except for causation) and that at the least it is established that the damage is the consequence of the intentional or negligent conduct of one of the persons or the consequence of the realisation of a source of danger for which one of these persons bears responsibility. It is thus not necessary that these persons, assuming causation in each case, have acted culpably or that their liability arises out of the same attributive cause.

Illustration 5

Cows from two different herds which graze on the same pasture attack a man and fatally injure him. It is later no longer possible to say whether just one cow caused the fatal injury or whether it was more than one and it is also no longer possible to determine, to which of the two herds the cow(s) belonged. Both of the respective keepers of livestock are solidarily liable. Persons who, without being livestock keepers themselves, were to supervise the animals and neglected to carry out the supervision necessary under the circumstances are likewise solidarily liable (VI.–3:102 (Negligence)).

The damage must be caused by one of two or more occurrences. It is, however, necessary that “it [be] established that the damage was caused by one of these occurrences”. This is not the case where it is unclear whether one of the occurrences brought about the damage at all. VI.–4:103 particularly does not bring in any market-share-liability, thus no *pro rata* liability for damage from products of an ambiguous origin attributed according to the market share of their manufacturers.

Illustration 6

The claimants’ mothers had during their pregnancy taken medication, which was marketed in the same chemical formula under different brand names by competing companies. This medication caused the claimants to suffer from cancer of the uterus years later. They cannot say, however, which brand of medication the mothers bought at the time, nor even whether the medication taken came from any one of the companies which they now seek to hold liable; the medication may well have come from a company which does not exist any more. VI.–4:103 does not help the claimants’ with either of these difficulties. An “occurrence” within the meaning of VI.–4:103 is lacking. This is because even if all of the companies were active and present in the market, the claimants could not prove that each had unleashed a danger on their mothers. In other words, it is not even ascertained that any one of the mothers took medication from *different* companies. The people involved simply cannot remember who brought about the cause of damage. This does not suffice for VI.–4:103.

Defences. Each person accountable for one of the occurrences may not only prove a lack of responsibility for the damage due to factual reasons, but may also show that another defence from Chapter 5, including the possible contributory fault of the injured person, is available.

Illustration 7

Several children throw stones in the injured person's direction. It is no longer possible to establish which child hit the injured person's eye with a stone. The parents of one of the stone throwers can prove, however, with the aid of a witness who happened to be at the scene, that in any event the only stone thrown by their child went in a different direction. Only the other parents are liable.

Illustration 8

The injured person, X, was consecutively employed by several employers and was exposed to asbestos dust at the workplaces. The severe lung disease that X contracted can be caused by even a single inhalation of particular asbestos particles. It is consequently unclear whether the disease was contracted when X worked for employer A or employer B; it is clear only that both acted negligently. A and B are solidarily liable. If contributory fault is attributed to X because of a failure to wear the necessary protective clothing, X's claim is to be correspondingly reduced, and this holds true whether the contributory fault occurred during the period of employment with A or with B. In contrast, if X had occasionally pursued the same occupation in a self-employed capacity, so that the cause of the illness could have been due to that independent exposure during the same time period, VI.-4:103 does not apply. In such a case it cannot even be established that either A or B caused the damage.

CHAPTER 5: DEFENCES

Section 1: Consent or conduct of the injured person

VI.-5:101: Consent and acting at own risk

(1) A person has a defence if the injured person validly consented to the legally relevant damage and was aware or could reasonably be expected to have been aware of the consequences of that consent.

(2) The same applies if the injured person, knowing the risk of damage of the type caused, voluntarily incurred exposure to that risk and is to be regarded as having accepted it.

COMMENTS

A. Chapter 5 in overview

The notion of defence. The subject-matter of this Chapter is the defences open to a person against whom a claim is made under this Book. Even where the requisites of VI.-1:101 (Basic rule) are fulfilled, such a person is relieved of liability where and to the extent that one of the defences in this Chapter is available (see VI.-1:103 (Scope of application) sub-paragraph (a)). It is to be assumed that, under the general rules of evidence, the factual prerequisites for a defence are to be presented by the person founding on them and where contradicted must then be evidenced. A defence can extinguish liability but may also, depending on its type and on the circumstances, be used to reduce the level of damages.

Five Sections. The five Sections in the Chapter are structured not according to dogmatic categories, but according to predominantly factual aspects. In particular, they are not based on the distinction known to some legal systems between “justificatory” and “exculpatory” grounds. This is because technically speaking the category of “justificatory grounds” requires “unlawfulness”, which is not actually one of the requisites of liability for these model rules (VI.–1:101 (Basic rule)). Section 1 contains those defences that are derived from consent or other contributory conduct on the part of the injured person, like consciously incurring danger or participating in a criminal act. Cases of justifiably serving one’s own or another’s interests are the subject-matter of Section 2, with Section 3 handling situations where the damage-causing risk was uncontrollable. Section 4 deals with contractual terms excluding or limiting liability and Section 5 deals with a particular problem in the area of damage suffered by family members.

Further defences. Further defences may result from Book III (in particular Chapter 7 (Prescription)) and indirectly also from such rules of national law as are mentioned in Chapter 7 of this Book (Ancillary rules). This is because these model rules are silent on issues that permeate the law on extra-contractual liability from other legal quarters. Thus, further defences may be derived from e.g. the fundamentally protected rights to freedom of opinion and of the press or from the special protection of marriage and the family which is constitutionally guaranteed (see VI.–7:101 (National constitutional law)). Judges and lawyers may enjoy certain privileges in relation to the law on liability (see VI.–7:103 (Public law functions and court proceedings)), and employees are often not personally liable for damage that they inflict on other persons in the course of their employment unless very strict conditions are satisfied (see VI.–7:104 (Liability of employees, employers, trade unions and employers’ associations)). This Book leaves these issues (and their corresponding defences) completely untouched. Apart from such matters the list of defences in the present Chapter is formulated conclusively. The Group saw no adequate grounds for having more rules on exceptions than are here mentioned.

B. Consent (paragraph (1))

The basic principle. Paragraph (1) expresses a rule which is to be found in all European systems of law on non-contractual liability for damage, although it is only rarely codified expressly: any person who inflicts damage (that is legally relevant, within the meaning of Chapter 2) on another with the latter’s previous consent, commits no civil wrong. It would have been possible to formulate the rule so as to provide that damage which is occasioned with the consent of the victim is not legally relevant *vis à vis* the latter party, but that would have lost the element that the person committing the injury must make out the requisites for (effective) consent. Of course, this does not rule out the reality that there are cases in which the previous consent of the injured person to certain conduct also leads to the situation under these rules that the very existence of legally relevant damage is to be denied. Such situations no longer involve paragraph (1) of the present Article.

Illustration 1

A theft (and consequently an infringement of property rights) is not committed by a person who takes another’s property with the owner’s permission; a breach of confidence is not committed by a person who is authorised by the relevant person to publish the entrusted information. Upon approval, it ceased to be “confidential” within the meaning of VI.–2:205 (Breach of confidence).

The injured person. Paragraph (1) covers legally relevant damage of every type. An “injured” person is therefore not only someone who suffers a bodily injury (for fatal injuries, see VI.–5:501 (Extension of defences against the injured person to third persons)), but also any person who has consented to damage of another type, e.g. property damage. (See also the definition of “injured person” in Annex 1.) On the other hand, paragraph (1) assumes that in principle one can consent to an infringement of one’s own bodily integrity, e.g. to an operation, a tattoo, to the cutting of hair or to certain sexual practices that are connected with the infliction of pain.

Non-contractual liability and contract. The consent can be part of a contract (e.g. a contract with a construction company on the demolition of a building or a contract for medical treatment). It can also constitute counter-performance for some payment or other performance by the other party (permission, in exchange for payment, to exploit a copyright or to build over the border between two pieces of land). Issues such as whether the consent in such cases is to be qualified as the acceptance of an offer for the conclusion of a contract or as the fulfilment of a contractual obligation and whether the contract law regime displaces the law on non-contractual liability, are questions to be answered solely by contract law. In principle, contractual and non-contractual liability freely compete under these rules, see VI.–1:103 (Scope of application) sub-paragraph (c).

Illustration 2

X commissioned Y to chop down trees in X’s nursery and shred them. A dispute emerges as to whether X had also instructed Y’s workers to chop down lime trees and oak trees to the left and right of a path. Y has the burden of proving this instruction. This affects X’s claim in damages against Y as well as Y’s (possible) claim for payment from X under their contract.

Consent, acting at own risk and contributory negligence. Consent and acting at one’s own risk will rule out a claim in damages. Where contributory fault alone is in issue the claim may also be completely precluded under special circumstances; but this is not the case as a rule. In a case where contributory fault is present, the claim is typically only partially reduced (VI.–5:102(1) (Contributory fault and accountability)).

Illustration 3

An employee of a farm-owner transports an inebriated man on a tractor trailer, together with a large amount of wood. Soon after the driver starts to travel with excessive speed and the passenger is thrown from the trailer and crushed by its wheels, suffering severe bodily injury. The employer of the tractor driver is liable for the damage because the passenger did not consent to the harm or voluntarily expose himself to the risk of injury in such a manner that it must be inferred that he accepted it. The injured man is, however, subject to 50% contributory fault.

Consent. The previous agreement of the injured person is what is to be understood under the term “consent”. Subsequent agreement (“approval”) can have the effect of waiving a claim in damages but does not take away the unlawful character of the behaviour. The situation is different only in cases in which the approval transforms an originally unlawful act into a lawful benevolent intervention in another’s affairs, see V.–1:101 (Intervention to benefit another) paragraph (1)(b) and VI.–5:202 (Self-defence, benevolent intervention and necessity) paragraph (2). Consent need not be expressly given; it may result from the circumstances thus it is implicitly conferred. The person giving consent decides on the scope of the consent; a

mistake by the other person on the extent of the consent given may exclude negligence, depending on the circumstances of each individual case.

Illustration 4

By way of a clearly visible sign, the owner of a car park warns persons who store their vehicles on her premises without authorisation that she will demand a release fee. In order to enforce it, she puts a wheel clamp on the claimant's car. The claimant in this case gave implied consent to this infringement of property rights.

Illustration 5

A, an actress, is involved in a photo reportage. This implies agreement to publication, but not to the publication of any random photo, where it is clear under the circumstances that A wants to examine the selection in order to avoid the situation where pictures are released that in her view have not turned out well.

Consent as a defence against purposeful conduct. The defence of consent under paragraph (1) requires purposeful conduct on the part of the other person. "Consent" to inattention is excluded; such cases come under the rules on the acceptance of a risk in paragraph (2). In the case of the latter, the person accepting the risk knows that there is a specific danger and accepts it but then hopes that it will not transpire. Conversely, in consent cases, typically both sides envisage that the primary injury will occur. Of course, in such cases consent also rules out liability under Chapter 3, Section 2 (Liability without intention or negligence).

Illustration 6

A and B plan an insurance fraud. A drives A's worthless vehicle into B's already damaged vehicle, with B hoping to be able to shift the previous damage on to A's third-party insurance. B has neither a claim under VI.-3:101 (Intention) nor a claim under VI.-3:205 (Accountability for damage caused by motor vehicles) for the second damage and indeed not even where it is not A, but C who is the owner of the other vehicle.

Valid consent. Only valid consent will preclude liability. Paragraph (1) does not, however, specify the requirements for "valid" consent. Life is too multi-faceted and legal structure-requirements too complex for a detailed rule on this issue. The typical grounds of invalidity of consent are: lack of capacity of the injured person; the absence of sufficient information before the consent was given; and illegality or immorality.

Lack of capacity. Valid consent requires that the person giving consent be of sound mind. A person who, while completely inebriated, agrees to allow a similarly drunk contemporary to drive her home, does not confer valid consent and does not validly accept the risk of an accident. For persons under age, however, no general rule could be stated, because European rules for minors are not yet in existence (see I.-1:101 (Intended field of application) paragraph (2)(a)). The issue of minors' capacity to consent must therefore be developed from the Member States' general law on minors. Where the consent has the disposition of property as its contents or consequence, then it rests on the corresponding rules of the relevant applicable contract or property law. Often special rules apply to consent to medical operations. However, it can be said that even with the approval of the parents, curative medical operations against a minor's will are no longer admissible where the minor has attained a sufficient degree of maturity to make the decision not to be operated upon.

Informed consent. Consent is valid only where the person giving consent knows or at least has a general idea of what the other party plans to do and what consequences this conduct will have or could have, in the event that things turn out unfavourably. Therefore, paragraph (1) links this defence to the requisite that the person giving consent “is aware or could reasonably be expected to be aware of the consequences of that consent”. The rule thereby seeks to express the recognised rules on the requirement of “informed consent”. Its main field of application lies in the law on curative medical operations, for which – as long as they result from a contract – further elaboration is to be found in the commentary under IV.C.–8:108 (Obligation not to treat without consent).

Illegality. Consent can also be invalid because it contravenes the law or is incompatible with basic ethical values of the legal system. Of course, on a more specific level, the more pertinent question to be posed in each case is why a law prohibits certain behaviour (even making it criminally punishable) even in the case where the party injured expresses agreement with it. Where the prohibition does not serve the protection of the individual, but the protection of the public interest, then consent further rules out civil liability.

Benevolent interventions in another’s affairs. Where effective consent is lacking or where the consent granted does not extend to the actual concrete events, then the defence of benevolent intervention in another’s affairs in particular also comes into focus for the originator of the damage. Of course, the prerequisites for this must all be satisfied.

C. Acting at own risk (paragraph (2))

The basic idea. Paragraph (2) expresses a general consideration of justice. A person cannot complain about damage if that person has voluntarily incurred exposure to the danger of it arising and thereby indicated acceptance of the risk of damage occurring. The rule’s main practical field of operation lies in the realm of participation in martial arts or dangerous sports, but it is not confined to that. In principle its application is conceivable for all fields of the law on liability, e.g. as a defence against product liability, vehicle liability or liability for animals and as against liability for the unsafe condition of land, which would arise in its absence.

Systematic considerations. The rule also has the purpose of providing the defence of acting at one’s own risk with a self-contained and independent place in the overall system of liability. The circumstance that the claimant freely accepts the risk that is then realised can play a role in several contexts. Usually, the first test is whether the other person acted negligently under the circumstances. In football, for instance, physical contact is a part of the game and the higher the division, the higher the contact. Therefore, certain behaviour is allowed on the pitch that is prohibited in normal life, and even an infringement of the rules of the game does not necessarily lead to the inference of negligence. This is because not only do the rules of the game not equate with legal rules, they also frequently serve a different purpose than the protection of players. Even in combat sports, the defence of voluntary assumption of risk is only brought to bear where negligence on the part of the opponent or team-mate is established. Conversely, where the acceptance of a risk is in issue, there is no more room for a test of contributory fault; the acceptance of a risk rules out liability. This also applies where from the outset there is no room for a test for negligence because the basis of liability is the liability of a keeper within the meaning of Chapter 3, Section 2. Further, there is a certain proximity between the assumption of a risk and the contractual exclusion of liability. The defence of the voluntary assumption of a risk is not, however, bound to the restrictive prerequisites of VI.–5:401 (Contractual exclusion and limitation of liability).

Knowing the risk of damage of the type caused. Paragraph (2) requires that the injured person was aware of the type of damage risked. The amount or magnitude of the damage is not at issue here, but rather its type, thus e.g. personal injury, property damage, or economic loss.

Illustration 7

During a sailing regatta, a collision occurs, resulting in the death of one of the sailors. There is no room for the defence of voluntary assumption of risk because it did not relate to risking one's life.

Voluntary exposure to and acceptance of the risk. The decisive point is that the injured person voluntarily incurred exposure to the risk and that a neutral bystander would come to the conclusion that the injured person did indeed accept the risk (if not also the damage). To this extent, everything hangs on the circumstances of each case. One of the factors to be considered is the distinction between a mere leisure activity and a sporting exercise governed by rules; only in the latter case do the participants typically accept the dangers inherent in the sport because only then can it be said that it ultimately depends on the mere chance of "whom it will hit today". The form of the cause of damage is also to be considered, as well as why the injured person incurred the exposure to the risk.

Illustration 8

A football player kicks an opponent out of anger, leaving the opponent severely injured. At this point the ball is no longer near the incident because the flow of the game had shifted long before. There is no acceptance of this risk.

Illustration 9

A sixteen-year-old girl embarks on a trip with a female friend and two young men. The friend and one of the men split off from the group. In order to get home that evening (the last bus has already left), the girl sits in the other young man's passenger seat, although she knows that he only has a provisional driving licence. In an effort to show off, he drives too fast, causing an accident. The girl did not voluntarily accept the risk.

VI.-5:102: Contributory fault and accountability

(1) Where the fault of the injured person contributed to the occurrence or extent of legally relevant damage, reparation is to be reduced according to the degree of such fault.

(2) However, no regard is to be had to:

(a) an insubstantial fault of the injured person;

(b) fault or accountability whose contribution to the causation of the damage was insubstantial; or

(c) the injured person's want of care contributing to that person's personal injury caused by a motor vehicle in a traffic accident, unless that want of care constituted profound failure to take such care as was manifestly required in the circumstances.

(3) Paragraphs (1) and (2) apply correspondingly where the fault of a person for whom the injured person is responsible within the scope of VI.-3:201 (Accountability for damage caused by employees and representatives) contributed to the occurrence or extent of the damage.

(4) Compensation is to be reduced likewise if and in so far as any other source of danger for which the injured person is responsible under Chapter 3 (Accountability) contributed to the occurrence or extent of the damage.

COMMENTS

A. General

Contributory fault, contributory fault of auxiliary persons and contributory sources of danger. Strictly speaking, this Article features three defences. Paragraphs (1) and (2) involve the personal contributory fault of the injured person. Paragraph (3) clarifies that the injured person is also to be imputed with the contributory fault of an employee or representative for whom the injured person is responsible and paragraph (4) relates to the circumstances in which compensation is to be reduced because of the injured person's own responsibility for a contributory source of danger. The legal basis of liability on the part of the injuring person does not matter; this Article relates both to those situations in which liability is based on intention or negligence and those in which liability is strict.

Reparation. This provision is applicable to all forms of reparation, not only to compensation (i.e. reparation by means of monetary payment: VI.–6:101 (Aim and forms of reparation) paragraph (2)). Admittedly this will only rarely be practically relevant, but it is conceivable, e.g. where damages are to be rendered *in natura* in the form of the carrying out of work and this can be confined to a part of the necessary repairs.

Contribution to the occurrence or extent of the damage. The Article refers throughout to contributory responsibility on the part of the injured person for the materialisation of the damage as well as to contributory responsibility for the extent of the damage. This corresponds to III.–3:704 (Loss attributable to creditor), which the present Article concretises and (partially) modifies for the purposes of the law on non-contractual liability. Where both points of view coincide (contributory responsibility regarding the materialisation of damage as well as with respect to the extent of the damage) then account must be taken of both together.

Type of damage. The type of legally relevant damage makes no fundamental difference. However, paragraph (2)(c) provides a special rule for bodily injury resulting from traffic accidents.

The mirror principle. In essence (and apart from some exceptions mentioned below) this Article is built upon what might be called the “mirror principle”: everything which can go towards establishing accountability and thus liability on the part of one party for a legally relevant damage can (wholly or partially) reduce liability when the roles are reversed and it is the injured person's conduct or source of danger which is under scrutiny. This approach did not cause controversy. The legal order is not allowed to be “blind in one eye”: whatever is advantageous for the injured person, as regards the law of liability, should also act to the injured person's disadvantage in the reverse situation. The injured person's claim indeed remains in principle preserved (if not ruled out by another defence), but its amount is reduced. The claim is entirely cut down (“reduced to zero”) only in cases in which it may be said that the injured person's contributory fault outweighs the injuring person's responsibility to such an extent that there is no more room for liability on the part of the latter. Of course, in cases of this type, negligence of the injuring person or the realisation of a risk justifying liability will often already be absent.

Exceptions. The mirror principle is only capable, however, of being the starting point for the formation of the rule. It is not without its limitations, from a theoretical standpoint, as well as from a policy point of view. Neither “intention” nor “negligence” within the meaning of VI.–3:101 (Intention) and VI.–3:102 (Negligence) can be given their normal meaning in relation to the victim and, in a nutshell, the policy question is invariably to what extent the protection of the victim will be deemed reasonable and necessary; to this end, paragraph (2) of the Article presents a number of compromises.

Fault. It is common ground that so-called “contributory fault” does not hinge upon negligence. This is because any person who harms himself or herself (or who co-operates in doing so) does nothing forbidden and consequently occasions no legally relevant damage. The issue is not that the injured person injures the liable person through the former’s conduct, but rather that the injured person must accept the consequences of having been careless with that person’s own rights and assets. The claim is reduced because the injured person has shown through the relevant behaviour that the protected personal interests were not in fact so important. The expression “contributory negligence” is therefore an unfortunate one. It is better to speak of “contributory fault”, not only because the injured person does not cause any harm to another person, but also because it better reflects why the claim is to be reduced, namely the adoption of a personally neglectful position towards one’s own interests. Consequently, in contrast to accountability, paragraph (1) (and, as far as the employee is concerned, also paragraph (3)) comes into operation only if there is genuine “fault” on the part of the injured person, that is to say, conduct which is improper or reprehensible or at least may be criticised in a moral or ethical sense.

Children and mentally handicapped people. For persons who are incapable of “fault” (such as small children and the mentally incapacitated) no such reduction of their claim can therefore arise. In the case of older children, account is taken of their immaturity and their incompletely developed capacity for reasoned deliberation. For the purposes of this Article children are not imputed with the contributory fault of their parents or supervisors. This is because children are not liable for their parents; rather, in the case of a failure to supervise, typically they are entitled not only to a claim against the third person causing injury but also a concurrent claim in damages against their parents. (The finer details of the latter claim may be specifically regulated by family law, however; this Book leaves such rules unaffected I.–1:101 (Intended field of application) paragraph (2)(c); VI.–1:103(c) (Scope of application)). In the case of preponderant fault on the parents’ part, the third person causing the injury must therefore bring in the parents under the mechanism of solidary liability in damages. It is conceivable, however, that the wrongdoing of a person who is taking care of the child (regardless of whether it is the parents or someone else) heavily tips the balance so much on one side that it causes the third person’s contribution to the cause or to a source of danger for which the third party is responsible to completely fade into the background.

Illustration 1

A fifteen-month old baby dies. Instead of giving him medication for relieving inhalation difficulties, his grandmother had given him a chemical product which removes toilet lime scale. The medication and the chemical product were next to each other in the closet. Indeed the chemical product had not been correctly packaged and labelled but, under the circumstances, that alone does not suffice to render the manufacturer liable for the child’s death. The parents and grandmother have behaved in such a grossly negligent way that the death of the child can no longer be deemed as having been caused by the packaging and labelling defects.

Paragraph (2). In the interest of protecting the injured person, paragraph (2)(a) and (b) provide that immaterial contributory fault and an insignificant contribution to the cause are to be disregarded. Less care is necessary when dealing with one's own personal interests than in dealing with those of another; a bicycle thief cannot use the argument against the victim of the theft that the bicycle was not locked. In the "normal" cases of the negligent infliction of damage, it is also to be considered that liability - though this is considerably less so for the economic consequences of contributory fault - is insured against or insurable. Paragraph (2)(c) allows for the special dangers of road traffic and takes up a widespread tendency in European general liability law in affording more robust protection for traffic accident victims than for those who are injured in other areas of life, e.g. when playing sport or in their free time.

B. Contributory fault (paragraph (1))

Fault contributory to the materialisation of the damage. Paragraph (1) contains the basic rule on contributory fault: a person who, through fault, is a contributory cause of the damage must accept a reduction in compensation, depending on the degree of this fault. "Fault" means intentional or neglectful harm to one's own interests. Where the injured person intentionally caused the accident, the liability will usually be reduced to zero. The dependants of a person who commits suicide by jumping in front of a car do not even have a claim against the driver, cf. VI.-5:101 (Consent and acting at own risk) and VI.-5:501 (Extension of defences against the injured person to third persons). A reduction of the claim due to the intentional contributory fault of the injured person mostly crops up in cases in which that person intentionally and unreasonably refuses to minimise damage that has already occurred. Even in cases where grossly negligent fault contributes to the materialisation of the damage, a reduction of the claim to zero is by no means rare; cases of this type often border on the defence of an inescapable event (VI.-5:302 (Event beyond control)).

Illustration 2

The claimant was bitten by X's dog, but had ignored a clearly visible sign saying "Beware of the dog". The claimant must accept a reduction in the claim for damages.

Illustration 3

A law, which seeks to protect gamblers from the dangers of an addiction to gambling and the detrimental effects it can have on one's life, requires casinos not to admit certain gamblers. A casino which has breached this duty cannot defend itself with the argument that the claimant is guilty of contributory fault by not respecting the ban.

Illustration 4

A patient admitted to a psychiatric clinic jumps out of the window and kills himself. The personnel of the clinic were aware of the danger of suicide but did not deal with it. The family members' claim (cf. VI.-2:202 (Loss suffered by third persons as a result of another's personal injury or death)) is not to be reduced (see VI.-5:501 (Extension of defences against the injured person to third persons)).

Reduction of liability. The claim is to be reduced according to the degree of contributory fault on the part of the injured person. The result is mostly a division of liability; the proportions will depend on the circumstances – for instance one third to two thirds or one fifth to four fifths. In appropriate cases – where contributory fault is overwhelming – reduction of the claim can even mean a complete denial of compensation.

Co-responsibility for the extent of the damage. The contributory fault of the victim is still relevant to mitigation of the claim where it relates not to the materialisation of the damage, but to its extent or amount. In principle, this requirement to minimise damage is independent of the type of damage occasioned. Under paragraph (1) it also relates to the minimisation of patrimonial consequences of a bodily injury. However, the injured person is only required to take or permit reasonable measures; there is no requirement to take new risks.

Illustration 5

A local newspaper had falsely reported that the claimant had been caught having sexual intercourse with another man during the wedding breakfast. Subsequent to this, the national press also reported on the story. The claimant's lawyers first made the issue "properly public" through their request to her to hold a large press conference on the day after the wedding. This made the damage worse; the claimant's claim in damages against the media is to be reduced by approximately one third.

Illustration 6

A woman and her daughter are seriously injured in an accident. The woman must close her butcher's shop for several years. When she is fit for work again, the machines are outdated and she has lost her customers; the business has become worthless. In fact the woman had the opportunity of continuing the business in between with staff, but did not want to do this. Her claim in damages due to the loss of business is to be reduced by a high fraction.

C. Exceptions (paragraph (2))

Insubstantial fault and causation. Paragraph (2)(a) contains a clarification in relation to paragraph (1): very minimal contributory fault is not to be taken into account. This means that it is left out of account altogether. A reduction of the claim by merely nominal percentages is not to be undertaken; the minimum threshold is usually set at 10%. This corresponds to widespread court practice, saves work for the judiciary, is in line with the considerations that support the defence of contributory fault and reflects in this area the rule of liability in VI.-6:102 (De minimis rule). Paragraph (2)(b) contains a comparable rule for cases in which the injured person's causal contribution is negligibly low, regardless of whether it concerns the causal contribution of the fault or the causal contribution of a source of danger for which the injured person is responsible. However, there is an intrinsic relationship between the reason for the claim and the issue of whether the victim's contributory fault is inconsequential or substantial.

Illustration 7

A postal worker, P, steals credit cards out of letters sent by banks. Using the cards, P is able to withdraw money from the injured parties' accounts at an ATM. P obtains the necessary PIN numbers from the bank's customers by posing as the bank official who is investigating the whereabouts of the credit cards. In light of P's elaborate criminal scheme, what is involved here is merely negligible inattention on the part of the customers; their claim against P and P's employers is not reduced.

Traffic accidents. Paragraph (2)(c) contains a special rule for traffic accidents. In cases of bodily injury as a result of a traffic accident, contributory fault only gives cause for reducing the claim if it constitutes a gross disregard of one's own safety. This rule reflects a widespread tendency of European systems of liability – namely affording special protection to victims of traffic accidents. Encountering road traffic constitutes an unabatedly high risk. Slight breaches of the rules happen every day and are a reality of life. The originator of the damage is

normally insured against liability; conversely, a pedestrian or cyclist affected outside the course of employment can only rarely shift the pecuniary consequences of contributory fault to an insurer. This lack of balance is at least partially remedied by paragraph (2)(c). This provision pertains to contributory fault in the materialisation of the damage, not a failure to minimise the damage. It only affects damage that falls under the scope of application of VI.–3:205 (Accountability for damage caused by motor vehicles). Where on an icy winter's day a person wearing slippery leather shoes walks on an ungritted pavement, a reduction under paragraph (1) ensues; it is only traffic accidents caused by a motor vehicle which are covered by paragraph (2)(c).

Policy considerations. Due to varying conceptions on the form of contributory fault on the part of traffic accident victims which should be afforded consideration (in relation to its capacity to reduce the claim), on who is to be deemed the “weaker candidate” enjoying a claim to special legal protection and on the type of damage that should be covered by this protection, paragraph (2)(c) suggests a middle ground: where bodily injury is at issue, everyone is affected in a special way and is at the mercy of the dangers of road traffic. Therefore, it did not seem advisable to include further distinctions between the various categories of persons. On the other hand, with property damage, the usual care in dealing with one's own goods can also be required where traffic is concerned; in the case of contributory fault, it would not be reasonable to allow virtually the entire weight to be shifted on to the risk borne by the other party's indemnity insurance.

Gross negligence. As far as bodily injuries are concerned, where the injured person has behaved in a grossly negligent manner, the limit of the special rule in paragraph (2)(c) has been reached. Depending on the grounds for the liability, in such cases the claim is to be reduced or even ruled out altogether. Gross negligence is a profound failure to take such care as is manifestly required in the circumstances. Standard examples include not buckling one's seatbelt, drunkenness at the wheel or driving through a red light.

D. Extension of the mirror principle to the law of strict liability (paragraphs (3) and (4))

Contributory fault of employees. Paragraph (3) concerns cases in which employers must accept a reduction in their claim to reparation on account of the contributory fault of their employees.

Illustration 8

Small children are gathered around X's company car; using a screwdriver, they want to see whether they can succeed in putting a scratch in the paintwork. The company's employees follow the goings-on, but do not intervene. Liability to the company on the part of the parents does not arise because the company's employees willingly allowed the damage to occur.

Contribution of a source of danger. When considering the injured person's contribution, it is not only *contributory fault* in the sense of intentional or careless harming of one's own interests which follows from the mirror principle; in fact, another element is to be weighed up: where in an individual case, a source of danger - for which the injured person would be liable under Chapter 3, Section 2 (Accountability without intention or negligence) - contributes to the accident or to its consequences, it would be that person's role as an *injuring* party which is at issue. That is the content of paragraph (4). This rule is of particular importance where the strict liability of the two parties collide, but it also has significance where the injuring party must be deemed contributorily responsible for the accident due to

negligence and the injured person is also seen in such a light, but owing to an objective ground; both cases have the restriction that the intervention of the injuring party does not constitute an unavoidable occurrence from the perspective of the injured person (mirrored application of VI.-5:302 (Event beyond control)). It is worth noting that in the context of paragraph (4), paragraph (2)(b) remains applicable: an insubstantial contribution to the causal element is not deemed capable of reducing the claim. Where necessary, in the case of the collision of two strict liabilities, an amendment to the result is to be made with the aid of VI.-6:202 (Reduction of liability).

Illustration 9

An accident between two vehicles occurs in the middle of a road consisting of two lanes going in opposite directions. It is no longer possible to establish which of the vehicles had crossed over the line in the middle of the road. A's vehicle, a larger and more expensive car, has suffered damage to the extent of €20,000; B's vehicle, a budget-priced "student car", has suffered damage to the extent of €2,000. Each of the owners bears half of the damage to each car; A has a claim against B for €10,000, from which €1,000 will be deducted in the course of the setting-off calculations.

Illustration 10

A drives into B's vehicle, which was correctly positioned in the traffic. The contribution of B's vehicle to the cause is so slight that B's claim against A is not reduced.

Illustration 11

Messenger pigeons get caught up in the jets of an aeroplane set to land, leaving it considerably damaged as a result of the collision with the birds. The owner of the messenger pigeons is still ascertainable. Here the basic rule is again that each of the owners involved (supposing that the liability of the owner of the aeroplane is also strict, see VI.-3:207 (Other accountability for the causation of legally relevant damage)) bears half of the other party's and half of its own damage. However, account is to be taken of the fact that aeroplanes are far more dangerous and it must be expected that their owners can draw on insurance premiums, in the context of VI.-6:202 (Reduction of liability). In the case of a private pigeon keeper, the liability is even to be reduced to zero due to considerations of equity and fairness.

VI.-5:103: Damage caused by a criminal to a collaborator

Legally relevant damage caused unintentionally in the course of committing a criminal offence to another person participating or otherwise collaborating in the offence does not give rise to a right to reparation if this would be contrary to public policy.

COMMENTS

Ex turpi causa non oritur actio. The maxim *ex turpi causa non oritur actio* is known to many, but not all, of Europe's legal systems. It is sometimes restricted to the law of unjustified enrichment but in some other systems is a well-established part of the law on non-contractual liability. This Article follows the latter model. The defence not only partially overlaps with the defences of contributory fault and acting at one's own risk, but also adds new dimensions to the question of whether a person has acted negligently at all. However, in none of these three systematic categories can the true character of this idea be unqualifiedly

expressed, namely that an injured person may lose a claim to compensation through particularly dishonourable conduct.

Illustration 1

Two young men steal a car; A drives, B sits in the passenger seat. A negligently causes an accident, through which B is injured. B has no claim in damages against A. The reason for this under these model rules is not that A did not owe to B a duty of care, nor that B was guilty of contributory fault, nor that he acted at his own risk. The reason for the exclusion of liability is the participation of the injured person in the theft and the inevitable getaway.

Illustration 2

The position is the same where other things, apart from a car, are stolen, and as a consequence of drunkenness in the undertaking of the crime or the subsequent getaway, an accident occurs. The injured person sitting in the back seat has neither a claim against the driver nor a claim against the owner who was sitting in the front passenger's seat.

Illegality. A further argument in favour of the rule in this Article is that it would not be plausible if, as the case may be, an unjustified enrichment could not be retained due to illegality (see VII.–6:103) (Illegality)) but the claim in damages were to stand (see VI.–6:101 (Aims and forms of reparation) paragraph (4)).

Burden of proof. Technically speaking, what is involved is a defence because the person seeking to escape liability must prove that the rule's requirements are in fact met. Indeed, this is not entirely unproblematic, because public ends are also served by the maxim *ex turpi causa non oritur actio*; however, this is unavoidable in the law of civil procedure.

Damage must be caused unintentionally. It does not flow from the recognition of the maxim *ex turpi causa non oritur actio* that the injured person is stripped of all rights. It is not about denying an injured person all legal protection, but about avoiding the absurdity of a legal system developing standards of care for the conduct of criminals *vis à vis* each other. The provision therefore only excludes those rights to reparation which one participant in a crime unintentionally confers on another participant in the very same crime.

Collaborator. The Article covers only damage to a participant in a criminal act by a fellow participant. The term collaborator or collaboration has the same meaning as in VI.–4:102 (Collaboration).

Illustration 3

While fleeing the scene of the crime, a young delinquent is shot dead by an over-zealous security guard, whose job was merely to call the police in the event of the threat of theft. The victim's parents do not lose their claim by virtue of this Article.

Reparation must be contrary to public policy. Collaboration in a criminal act should not automatically defeat a right to damages against another participant. In view of the multi-faceted nature of everyday life, it seems to be preferable to once again subject the outcome to a test of justice and fairness. The Article incorporates such a control mechanism through the criterion that a right to damages is only to be excluded where awarding it would be contrary to public policy. Ultimately this decision depends on the circumstances of each individual case,

particularly on whether the injured person is injured in a manner that is directly connected to the participation in the criminal act.

Illustration 4

A and B are involved in a brawl and are thus criminally punishable. In full knowledge of his physical superiority, the younger of the two, A, who was provoked by B, hits B so hard that he fractures his skull. Even where it can be inferred that A did not intentionally inflict this injury to B, VI.–5:103 does not stand in the way of B’s claim.

Section 2: Interests of accountable persons or third parties

VI.–5:201: Authority conferred by law

A person has a defence if legally relevant damage is caused with authority conferred by law.

COMMENTS

General. A person who is exercising an authority conferred by law and who remains within the bounds of this authority does not incur non-contractual liability, even where the conduct harms another. The present Article formulates this universally accepted principle as a defence. This is because the person seeking to found on the rule has the burden of proving the factual prerequisites for its application.

Applicable to private persons only. The Article relates only to private persons and not to public bodies or other persons, such as police officers, exercising public law authority. That follows from I.–1:101 (Intended field of application) paragraph (2) as well as from VI.–7:103 (Public law functions and court proceedings). Liabilities arising out of the performance of public law functions are altogether excluded from these model rules.

Relation to other defences. The defence provided by the Article is a residual defence, which helps to slot this Chapter neatly into the overall legal order. It refers to the authority which the law grants to the injuring person in a different, separate arena (i.e. outside this Book). While it could indeed be argued that further defences in this Book confer legal authority to harm another, there is still the systematic consideration that these defences are not at issue here or – and this boils down to the same result – take priority over this Article as *leges speciales*. The defences in VI.–5:202 (Self-defence, benevolent intervention and necessity) are prominent members of this group. Furthermore, the present Article is focussed on, and more heavily justified by, the injuring person’s standpoint rather than the victim’s predicament.

Scope. The Article covers a wide range of situations. It covers such disparate cases as the lawful arrest of a criminal by private individuals pending the arrival of the police, damage to the environment based on special statutory or regulatory permission, the authority to report the suspicion of criminal activity to the police, the authority to enter another’s land while hunting, the authority to take water from a river, and even the relatively “harmless” case of rules governing rights of neighbours, whereby proprietors may cut back vegetation protruding on to their land from the adjacent property.

Illustration

A woman harassed by a sex offender follows him in her car. She cuts across his getaway car with her own car in order to stop him and to allow him to be arrested by the police, whom she herself has notified. The woman is not liable for the damage to the getaway car on the basis of intention nor in her capacity as keeper of the car causing the accident .

Authority. “Authority” within the meaning of this Article is held only by those authorised by law to interfere with the rights of others or to inflict damage on them in another manner. Therefore, it is particularly pertinent in the law governing liability for environmental impairment that there is exact examination into whether merely permission to carry out certain operations is concerned, which leaves the rights of third parties unaffected or takes from them only certain specific legal remedies (e.g. the right to demand that the operations be restrained, leaving the right to damages unaffected), or indeed whether the content of the permission is really the right to harm others or the environment without any consequences in terms of liability. It is comparatively rare for this type of permission to be given.

Conferred by law. The Article relates only to authority conferred “by law”. Thus, it does not apply to authority which has its basis in a contract or in the agreement of the affected party (in cases of a benevolent intervention attributable to an alleged agreement on the part of the affected person, the categorisation is naturally more difficult, but precisely because of this, these situations are also specifically regulated). Rather the Article is concerned with authority which results directly from the law as such. Conferred “by law” does, of course, not necessarily mean “conferred by statute”. It suffices that a legal norm allows the intervention in the form which occurred. The same applies to authority conferred on a person by an individual decision of a governmental body, which is based on a legal norm.

Limits. While the Article provides a defence against all forms of liability (thus, also against liability under Chapter 3, Section 2 (Accountability without intention or negligence)), it does not allow an abuse of rights. It was not necessary to individually express this in the text of the model rule because it is an inherent component of the term “authority conferred by law”: no legal system confers authority to act in abuse of the law.

VI.-5:202: Self-defence, benevolent intervention and necessity

(1) A person has a defence if that person causes legally relevant damage in reasonable protection of a right or of an interest worthy of legal protection of that person or a third person if the person suffering the legally relevant damage is accountable for endangering the right or interest protected. For the purposes of this paragraph VI.-3:103 (Persons under eighteen) is to be disregarded.

(2) The same applies to legally relevant damage caused by a benevolent intervener to a principal without breach of the intervener’s duties.

(3) Where a person causes legally relevant damage to the patrimony of another in a situation of imminent danger to life, body, health or liberty in order to save the person causing the damage or a third person from that danger and the danger could not be eliminated without causing the damage, the person causing the damage is not liable to make reparation beyond providing reasonable recompense.

COMMENTS

A. Three grounds of defence

Overview. This Article gives effect to two “classic” grounds of defence, namely self-defence (paragraph (1)) and necessity (paragraph (3)), and, in paragraph (2), to the ground of defence based on justified benevolent intervention in another’s affairs. The second sentence of paragraph (1) contains a clarification in regard to self-defence against children. Paragraphs (1) and (2) lead to a complete defence. Paragraph (3) has as its main consequence a reduction of liability to what is under the circumstances a reasonable recompense.

B. Self-defence (paragraph (1))

Protecting personal rights and interests and those of another. The law must not yield to injustice. Therefore, every Member State’s legal system recognises the right to self-defence. Precisely speaking, it is broken up into two characteristics: self-defence in the strict sense and the defence of others, namely protecting the rights and interests of another against danger from a third party. In contrast, self-defence against self-defence is not possible: such a protective measure would not be reasonable (as is required by paragraph (1) of the Article).

Illustration 1

A is attacked by B with a blunt object. A defends herself by attempting to destroy the weapon. B in turn defends his property. The latter is without good reason and may therefore be overcome by A by force, as long as B’s attack continues.

Endangerment. The defence of self-defence requires, first, the actual endangerment of a right or legally protected interest (see VI.–2:101 (Meaning of legally relevant damage)). An endangerment can lie in a person, a thing or an animal. Paragraph (1) is not limited to attacks by people.

Illustration 2

A is attacked by a dog whose keeper and owner is B. A is only able to defend himself by striking the dog with a slat which he tears from a wooden fence belonging to C. In relation to B, A acts in self-defence; the situation would only be different if B was the owner, but not the keeper of the dog (in which case paragraph (3) would apply in relation to B). In relation to C, it is paragraph (3) which applies. A is not liable to C under the general rules on non-contractual liability in this Book, but he is liable nonetheless to make reasonable compensation. On the other hand, C cannot defend himself against the intervention by A in accordance with paragraph (1). That is because A is not responsible under this Book for the property damage, nor would he be responsible for it if C had tried but failed to hinder it by force. B in turn is unequivocally liable for the damage to the fence under VI.–3:203 (Accountability for damage caused by animals) in conjunction with VI.–4:101 (General rule [on causation]); a break in the chain of causation by A’s conduct is to be denied.

Reasonable protection. A person who relies on this defence must also demonstrate, and if necessary prove, that the acts were done with defensive intent. Moreover the person must have opted for a means of defence that was reasonable under the circumstances. That will be so only where the means chosen were apt and necessary to fulfil the intended aim. Furthermore, the act of self-defence must not have been out of all proportion to the interest under threat – even if there was no other possibility of defence.

Illustration 3:

The owner of a cherry tree may not shoot at children who are stealing cherries and refuse to budge despite the owner's protests – even if the owner is confined to a wheelchair and has no other means to defend the property.

Self-defence against children. The second sentence of paragraph (1) clarifies that self-defence may as a matter of principle be exercised against children (provided that the act of self-defence is reasonable). A corresponding rule in relation to the mentally disabled is not necessary because, in principle, mental incapacity in the context of a ground for liability is not afforded any consideration. It only comes into focus as an independent defence (see VI.–5:301 (Mental incompetence)); self-defence is therefore also possible against attacks from mentally disabled or intoxicated perpetrators.

Putative self-defence and excessive self-defence. Paragraph (1) does not come into operation where a person misreads the situation and wrongly believes there is an attack (so-called putative self-defence), nor where there is indeed an attack but the person resorts to an unreasonable method of defence (so-called excessive self-defence). In both situations, the issue of liability is decided solely under VI.–3:102 (Negligence). Where the mistake was avoidable, negligence is present; where it was unavoidable, liability is absent.

Illustration 4

A strikes B, who has acted threateningly towards him and claims to have a weapon in his bag with A in mind. Since B is in truth not carrying any weapon in his bag, A is not acting in self-defence; however, he is not liable because he did not negligently infer an instance requiring self-defence.

Illustration 5

An employee of a security firm is attacked by an intruder, who threatens to kill him. A fight ensues, during the course of which the security guard shoots at the intruder and in an ironic turn of events ends up actually killing him. Under the circumstances, a non-fatal shot to the leg would have sufficed to defend himself. The widow has no claim where the security guard cannot be blamed for being negligent for over-reacting in a life-threatening situation.

C. Benevolent intervention in another's affairs (paragraph (2))

Benevolent intervention as a defence within the framework of the law on non-contractual liability. Interfering in the affairs of another under the prerequisites of V.–1:101 (Intervention to benefit another) and V.–1:102 (Intervention to perform another's duty) is quite allowed and indeed desired. Where the principal is harmed thereby, the intervener is equipped with a defence in the context of the rules in this Book, see the Comments under V.–1:101 (Intervention to benefit another) and illustration 3 there. Expressing that is the aim of paragraph (2) of the present Article.

Without breach of the intervener's duties. However, benevolent intervention is only a ground of defence if the intervention is carried out with all care due in the circumstances. Where the intervener breaches a duty of care *vis à vis* the principal's rights and interests, the intervener remains liable under the conditions set out in V.–2:103 (Reparation for damage caused by breach of duty).

D. Necessity (paragraph (3))

Situations covered. Paragraph (3) closes a gap in the law governing self-defence. It deals with situations in which a defence against a direct threat to life, body or freedom is possible only by making use of another person's property. Given the serious discrepancy between the legally protected interests in play here, the owner of the property must endure this interference and cannot block the original self-defensive action by in turn defending the property against it. A person who uses the property of another in legitimate self-defence does not commit a legal wrong. However, in so far as the owner is not responsible for the danger arising and can regard it as "none of his business", the owner has a right to reasonable recompense. Thus, paragraph (3) follows the maxim "endure, then claim". This "imperative endurance" is a part of the law on non-contractual liability for damage, the granting of a right to reasonable recompense is *strictu sensu* not. In actual fact, of course both parts of the rule are inextricably entangled; they are dependent on each other.

Precedence of the interest defended over the legally protected interest. Paragraph (3) covers only situations where there is a clear legal discrepancy between the values of the conflicting interests. This is a question not of economic comparison but of weighing-up moral values. The rule assumes that, in the situations mentioned, property rights, possessions and money cede to life, body and freedom. For conflict situations *within* both groups, a general defence cannot be formulated. Such situations have to be solved by reference to the general rules on liability for intention or negligence. In some cases recourse to VI.-6:202 (Reduction of liability) may be possible.

Illustration 6

The victim of a kidnapping is locked inside a stolen car or is detained in the rooms of a bank by the kidnapers, with a view to extracting a ransom. The kidnapped person may damage the car or the windows in the bank in order to flee. The same applies where a third party rescues the victim.

Illustration 7

Lady A is out and about in an expensive designer dress; Lady B is wearing jeans and a T-shirt. The difference in value of the clothes does not give Lady A the right to wrench Lady B's umbrella from her, after it has suddenly begun to rain.

Imminent danger. The special authority to interfere with the property of another arises only in cases of imminent danger to the life, body or freedom of the person in danger. Only dangers for which one cannot reasonably prepare and with which one cannot reckon are meant here. If it were otherwise, it would be possible to tackle the dangers without inflicting the damage.

Illustration 8

Where homeless people have not arranged a place to stay for the cold winter months in a timely fashion, paragraph (3) does not give them the right to break into houses, even where they are empty.

Liability. Under the law on non-contractual liability for damage, liability falls naturally on the negligent or intentional causer of the dangerous situation or the person who must account for the source of danger according to objective criteria. However, there will not always be such a person principally responsible (e.g. if the dangerous situation is attributable to natural events) and even where there is, the question remains as to who should bear the risk that that

person will be unable to pay the damages or will be unidentifiable. Paragraph (3) decides this issue in favour of the owner and to the detriment of the person who resorted to self-defence: the latter must bear the risk of not being able to recover damages from the principally responsible person, because the person resorting to self-defence, and not the owner, was the pro-active party.

Reasonable compensation. Equally, there often remains the delicate task of coming up with a solution to compensate for the damage which adequately serves the interests of the two parties. On the one hand, paragraph (3) provides for strict liability of a person acting in an emergency situation requiring self-defence, but then limits this liability, depending on its extent, to a reasonable compensation. The rule gives a certain amount of discretion to the court as regards the evaluation. It is not necessary to compensate the full damage; in fact a balance of values is more appropriate. The amount payable turns upon the time and market value of the damaged thing; in contrast, general damages are not recoverable, i.e. compensation for lost profit and losses of a non-pecuniary nature.

VI.-5:203: Protection of public interest

A person has a defence if legally relevant damage is caused in necessary protection of values fundamental to a democratic society, in particular where damage is caused by dissemination of information in the media.

COMMENTS

Purpose of the rule. This Article grants the originator of the damage a defence where the damage was caused in necessary protection of values fundamental to a democratic society. It gives effect to a principle which is rarely clearly visible in the black-letter law of the Member States, but is encountered in the jurisprudence on the law on non-contractual liability virtually everywhere. The Article should reduce the necessity to rely on VI.-7:101 (National constitutional laws). The latter provision cannot be expected to serve as a panacea for all problematic cases.

Protection of public interest. The primary significance of the rule lies in giving the press and other forms of media a defence in cases in which the person who is the subject of a report suffers legally relevant damage under the criteria set out in VI.-2:203 (Infringement of dignity, liberty and privacy), VI.-2:204 (Loss upon communication of incorrect information about another) and VI.-2:205 (Loss upon breach of confidence). The person must put up with such damage if the prerequisites of VI.-5:203 are satisfied. Very frequently there is a particular public interest in reporting on celebrities or leading personalities in political life. This also applies to the latter in relation to such news about their private lives as concerns their integrity and therefore is relevant to voters in deciding whether or not to vote for them. Moreover, the public interest in certain information can make particularly speedy reporting necessary, in the context of which the full accuracy of the disseminated news cannot always be guaranteed. Nor can it always be expected in such circumstances that the publisher or the organ of the press authoritatively assesses all the associated legal issues. Of course, the Article protects neither invented stories nor the reckless publication of untrue facts or mere rumours. However, in the case of journalistic investigations deemed to be of a reasonable intensity under the circumstances, it may be permissible to publish information which later proves to be partially false. Where the report is corrected upon learning the truth, no liability

arises. For accuracy's sake, of course everything depends on the conditions of each individual case; weighing-up the interests involved must be left to the courts.

Fundamental to a democratic society. If the Article is to apply, the mere existence of any arbitrary public interest does not suffice. Rather, basic values of a democratic society must be at issue, and the protective measure taken must be necessary. Included among the basic values of a democratic society are particularly freedom of expression and freedom of assembly. The Article can therefore be important in relation to the freedom to demonstrate. The participants in a large demonstration, for instance, are not liable for the fact that private persons cannot use their vehicles for a certain period of time or that delivery vans cannot reach a factory which the demonstration passes. Also the mere participation in the demonstration itself is not a ground for liability where under the circumstances it may be expected that rather violent people will join the demonstration. Certainly, the Article does not provide carte blanche for irresponsible carelessness in the planning and organisation of such processions, but seeks to ensure that the exercise of fundamental rights is not made factually impossible by the consequences of civil liability.

Section 3: Inability to control

VI.-5:301: Mental incompetence

(1) A person who is mentally incompetent at the time of conduct causing legally relevant damage is liable only if this is equitable, having regard to the mentally incompetent person's financial means and all the other circumstances of the case. Liability is limited to reasonable recompense.

(2) A person is to be regarded as mentally incompetent if that person lacks sufficient insight into the nature of his or her conduct, unless the lack of sufficient insight is the temporary result of his or her own misconduct.

COMMENTS

A. Policy considerations and overview

Options. In Europe, there is no prevailing uniformity on the issue of how harm caused by mentally disabled persons (typically, but not necessarily mentally incompetent adults) is to be dealt with reasonably by the law on liability. As a result, there were several options available. The rule could have been (i) formulated in such a way that a mental disability was either not considered in any respect or in any event did not come into consideration in the field of liability for negligence. It could also have been formulated in the exactly opposite manner, namely (ii) upon the principle that a mentally disabled person was, without exception, never liable for damage caused, or (iii) a middle ground between the two could have been taken up. That is the solution opted for in the Article.

The preferred solution. The Article takes as its starting point the consideration that a balancing of the interests of the injuring person and the injured person is necessary. The legal system should lose sight neither of the protection of the victim nor of the adverse circumstances of the injuring person who cannot be held responsible for his or her condition. A person who, due to mental illness, cannot distinguish between right and wrong (see

paragraph (2)), does not act “intentionally” within the meaning of VI.–3:101 (Intention); this is because such a person is not in a position to differentiate between arbitrary and legally relevant damage. On the other hand, the liability of a mentally disabled person in cases covered by the Chapter 3, Section 2 of this Book solely depends on whether - under the circumstances - he or she can be qualified as a “producer”, “keeper” or “occupier”. In the standard case that will usually be answered in the negative. However in the case of a sudden onset of mental illness exceptions are conceivable (see illustration 3 under VI.–3:102 (Negligence)). Therefore, the actual problem area is liability for negligence. Under VI.–3:102 (Negligence), deviation from the standard of care which can be expected from a reasonably careful person under the circumstances of the individual case is sufficient. Conduct caused by illness may constitute such a deviation; something like the average “care” taken by a mentally disabled person does not exist. As a consequence, in the terminology of these model rules a person with mental incapacity is “accountable” for negligently occasioned legally relevant damage under the same prerequisites as for someone of sound mind. However the present Article restricts the normal effects of this accountability in three different respects. Liability can (i) only lie in the duty to pay a sum of money from available assets; due to the nature of the situation, rendering compensation through reparation in kind is excluded from the outset. Liability lies (ii) not in the payment of the full monetary damages (“compensation”), but in a reasonable recompense (“recompense”). Hence, VI.–5:301 draws on the concept which has already been presented in VI.–5:202(3) (Self-defence, benevolent intervention and necessity) for the reparation of loss in an emergency situation necessitating self-defence. Both cases exhibit certain similarities. Even liability for reasonable monetary compensation under VI.–5:301, however, (iii) only remains justifiable where it conforms to equity and fairness under the circumstances, as might be the case if the liability could easily be borne by the liable person because of his or her favourable financial situation. On this point, the model of liability in VI.–5:301 is in accord with several (but in no way all) of the European legal systems. The considerations are similar to those relating to VI.–3:103 (Persons under eighteen) paragraph (3) on the personal liability of children. Of course the liability of children is subsidiary (VI.–3:103(3)(a)); the liability of mentally disabled adults is not.

B. Mental incompetence

Lack of insight. According to the definition in paragraph (2), a natural person is “mentally incompetent” if he or she is not in a position to grasp the nature of his or her conduct (act or omission), i.e. to foresee its possible consequences and to understand how society judges it in general. Typically the issue is that the person in question is not in a position to differentiate between right and wrong. A person who has this ability, but is not able to fashion his or her behaviour accordingly, is not mentally incompetent within the meaning of VI.–5:301, see illustration 3 under VI.–3:201 (Accountability for damage caused by employees and representatives). Also other physical disabilities, which do not have an effect on a person’s mental capacity, do not fall under VI.–5:301. They can only be taken into account in the context of VI.–3:102 (Negligence), depending on the circumstances of each individual case (see comments under that Article).

Temporary lack of insight. The lack of sufficient insight can be either temporary or permanent. However, where the lack of sufficient insight is only temporary, the conduct of the person concerned must be considered in order to determine whether the temporary lack of insight can provide a defence. Consideration must be given to what that person has done to bring about the condition and whether this amounts to misconduct. Thus an alcoholic who has suffered brain damage and has a permanent deficiency of insight into his or her conduct will fall under VI.–5:301, whereas a mentally fit and healthy individual who embarks on a one-off

“bender” and so puts himself or herself beyond proper self-control will not have a defence under this Article for damage caused during the drunken escapade.

Instinctive reflex actions. VI.–5:301 does not extend to bodily movements while in a state of unconsciousness and to the mere instinctive reflex actions of mentally competent persons. Such reflex actions do not constitute “conduct” within the meaning of this Book, see comments under VI.–3:102 (Negligence). In such a case there is no liability at all. The situation is different only where the injuring person should have anticipated having such episodes or reflex actions as a consequence of a physical problem and therefore should have refrained from the activity in question in advance.

Illustration 1

A dancer falls and to steady herself she reaches out to another dancer, who is pulled down and injured. That is not “conduct”.

Illustration 2

In the course of an operation, a doctor loses consciousness. If the loss of consciousness is attributable to a sudden and unforeseeable drop in blood pressure, the doctor is not liable for the harm caused to the patient; conversely, where the doctor should have been aware of the risk of such a loss of consciousness, then the doctor should not have been allowed to operate at all in the first place.

C. Recompense according to equity and fairness

Parallel comments. According to VI.–5:301(1) second sentence the originator of damage is liable for reasonable monetary recompense, subject to the proviso of equity and fairness. The concept of liability subject to equity and fairness has already been explained in comments under VI.–3:103 (Persons under eighteen) paragraph (3) and the concept of liability for a reasonable monetary recompense in comments under VI.–5:202 (Self-defence, benevolent intervention and necessity). Thus, reference can be made to both here.

Illustration 3

A suffers from schizophrenia. He notices that someone has turned off the light in his apartment. He takes a hunting rifle and shoots at two men, who are standing near the electricity meter: his father and an electrician. Both are killed. A comes from a wealthy family and commands a great personal fortune. The electrician’s dependants have a claim to reasonable monetary compensation. However, A must meet the necessary means for the maintenance of himself and his mother, who is financially dependent on him.

VI.–5:302: Event beyond control

A person has a defence if legally relevant damage is caused by an abnormal event which cannot be averted by any reasonable measure and which is not to be regarded as that person’s risk.

COMMENTS

A. General

Event beyond control as a defence in the framework of strict liability. This Article deals with the defence of an event beyond control. Under these model rules, this is only significant for the law on liability without intention or negligence. This is because where an uncontrollable event has caused the damage, then it is already a certainty that, to this extent, the person could not have acted negligently. Where an uncontrollable natural occurrence was, however, foreseeable and where the consequences of it could and should have been avoided by taking anticipatory measures, then under the criteria set out in VI.–3:102 (Negligence), negligence is to be affirmed. There is no room for VI.–5:302 here; the two provisions preclude each other.

Accountability without intention or negligence. This Article can also be important in the realm of employers' liability (VI.–3:201 (Accountability for damage caused by employees and representatives)) – however, only where the employee's liability does not depend on negligence.

Illustration 1

While dismantling his market stall, a trader leaves his unsold goods (items of clothing), packed in plastic refuse sacks, unattended behind his stall. Third parties unknown to him carry the bags to the side of the street. On their daily route, the local refuse collectors take the plastic bags with them; the pieces of clothing are mixed with domestic waste in the bin truck and are irreparably damaged. The refuse collectors did not act negligently (VI.–3:201(1)(b) (Accountability for damage caused by employees and representatives)). Their employer would not be liable even where it transpired that one of them was the owner of the truck: the defence in VI.–5:302 would not only be of benefit to the refuse collector, but also to the employer.

B. Event beyond control

Notion. An event beyond control is an abnormal occurrence which cannot be averted by any reasonable measure and which is not to be regarded as the realisation of a risk for which a person is responsible under Chapter 3, Section 2 (Accountability without intention or negligence). As far as possible and reasonable for the purposes of the law on non-contractual liability, this definition follows the corresponding rules provided by CISG art. 79(1) and III.–3:104 (Excuse due to an impediment) for contract law.

Two elements. An event beyond control is thus characterised by two elements – a factual one and a normative one. On the factual plane it is marked by the fact that the cause of damage would not have been discovered or precluded even if as much care had been taken as could possibly be expected in the circumstances. On the normative plane, damage must not have resulted from the realisation of the very risk on account of which liability is rendered strict. The Article does not address the distinction between “force majeure” and an “inescapable event”. This distinction is not prevalent in many Member States' private law systems and, even where it is recognised, the boundary between force majeure and inescapable event is often drawn by reference to different criteria. The defence under the Article does not depend on whether the actual cause of the damage is a natural occurrence or human behaviour (that of a third party or the victim), but on the fact that even where extraordinary care and prudence is exercised, it could not have been foreseen or, though foreseeable, could not have been avoided.

Abnormal event. The defence of an event beyond control only comes into play where an abnormal event was causative of the damage. Damage from the continuous operation of equipment would rarely constitute such an abnormal event. Nor would injury to health caused by the regular noise of low-flying aircraft. Everyday events do not lend themselves well to being termed events beyond control.

Illustration 2

An abnormal event would be where a bolt of lightning causes a sudden power cut, which in turn leads to an electrical cable being broken and a house being set on fire. Conversely, such an abnormal event is lacking where the power cut and subsequent cable breakage occur because birds have sat on a power line and momentarily connect it with another power line, so that a short-circuit occurs.

‘Not to be regarded as that person’s risk’. The predominant field of application for the defence is naturally that of strict liability. The purpose of the Article is not, however, to reduce the strict liability of keepers, occupiers, owners, producers or operators “through the back-door” to mere liability for negligence. Its sole purpose is to keep strict liability within the borders of the risk for which it exists.

Illustration 3

Where a terrorist ignites a bomb that has been deposited on a bus, the danger normally lying in vehicles is no longer an issue. From the point of view of the bus driver, this is an event beyond control exonerating him or her from liability.

Illustration 4

During the night, martens nibble at the brake cable of a car parked in a town. The conduct of the martens is “beyond any control”, but the risk that the car brakes do not function as the result of such an event must be borne by the keeper of the car.

Illustration 5

A fire breaks out in a train station because an extraordinarily strong gale throws a tree on to the electricity line and breaks it. The railway operator is not liable under VI.–3:202 (Accountability for damage caused by the unsafe state of an immovable) or under VI.–3:207 (Other accountability for the causation of legally relevant damage).

Relationship to contributory fault. In contrast to the defence of contributory fault, the defence of an event beyond control always leads to a complete exclusion of liability and never merely to an apportionment of damage. Where the victim’s contributory fault is totally dominant the result can, however, be the same because a reduction of liability “to zero” will then also come about by the application of VI.–5:102 (Contributory negligence and accountability).

Illustration 6

The facts are the same as in illustration 1, with the only difference that it is not third parties who place the refuse sacks filled with goods at the side of the street, but the market dealer himself. His contributory fault is so extensive that it is indistinguishable from an event beyond control.

Section 4: Contractual exclusion and restriction of liability

VI.–5:401: Contractual exclusion and restriction of liability

- (1) *Liability for causing legally relevant damage intentionally cannot be excluded or restricted.*
- (2) *Liability for causing legally relevant damage as a result of a profound failure to take such care as is manifestly required in the circumstances cannot be excluded or restricted;*
(a) *in respect of personal injury (including fatal injury); or*
(b) *if the exclusion or restriction is otherwise illegal or contrary to good faith and fair dealing.*
- (3) *Liability for damage for the causation of which a person is accountable under VI.–3:204 (Accountability for damage caused by defective products) cannot be restricted or excluded.*
- (4) *Other liability under this Book can be excluded or restricted unless statute provides otherwise.*

COMMENTS

A. Exclusion and restriction of liability

Pre-emptive exclusion of liability. This Article relates exclusively to the validity of a pre-emptive exclusion or restriction of liability. It is not concerned with agreements on liability after the event giving rise to the damage. Once liability arises, any agreed absolution from that liability is a transaction relating to an existing debt. That is not an ‘exclusion’ of liability. *Ex post facto* agreements as to liability are therefore subject to no special restrictions; nobody is obliged to exercise a right (apart from cases where a person is bound in some such capacity as a guardian to make a claim on behalf of a ward.)

Exclusion and restriction of liability. The Article covers both contractual arrangements for the complete exclusion of possible subsequent liability and arrangements under which the materialisation of such liability is made dependent on certain circumstances (e.g. no liability in cases of slight negligence) or its level restricted. Included are all agreements which put the subsequently injured person in a worse position than if there were no rules on non-contractual liability.

Implied exclusion of liability. An exclusion or reduction of liability does not have to be expressly agreed upon. A contract with this effect can come into existence implicitly.

Illustration 1

Where help is provided out of courtesy in rescuing a lorry which is stuck, an implied exclusion of liability for slight negligence is to be inferred in all events where the rescue is risky due to the surrounding local conditions and available aids.

Contractual exclusions. Agreements as to liability require a valid contract between the injuring person and the injured person. This in turn is subject to the general rules, particularly the provisions on concluding a contract, and the invoking of standard terms and their validity. In a range of cases, the restriction of liability by contractual terms is already struck at under II.–9:411 (Terms which are presumed to be unfair in contracts between a business and a

consumer) paragraph (1)(a). These provisions remain unaffected by VI.–5:401, see VI.–1:103 (Scope of application) sub-paragraph (c).

Unilaterally imparted information. Unilaterally imparted items of information do not constitute agreements restricting or excluding liability within the meaning of this Article. Their significance for the law on liability lies in other fields. So, for example, a remark by the provider of information that “no liability is accepted” for the accuracy of the information imparted can lead to the recipient of the information having no reasonable ground to rely on the accuracy of the communication within the meaning of VI.–2:207 (Loss upon reliance on incorrect advice or information) paragraph (1); see Illustration 2 under that Article. Often the very wording of unilaterally provided items of information does not contain a statement as to liability, but rather draws attention to a particular source of danger (“During snowfall and icy weather, this path will not be cleared”, or “Beware of biting dog”). Then, depending on the circumstances, it may have to be decided whether the information justifies the inference that there was no negligence, that the piece of land was not in an unsafe state or that overwhelming contributory fault is to be ascribed to the injured person because that person proceeded, without good reason, into a situation known to be dangerous.

Freedom of contract. The Article stems from the principle of freedom of contract. This allows the parties to set precautionary stipulations in relation to non-contractual liability possibly arising between them in the future. Paragraph (4) reflects this principle.

Basis. The rationale behind the extension of the principle of freedom of contract to non-contractual liability is not self-evident. Under these model rules it follows primarily from the principle of free concurrence of contractual and non-contractual claims (*‘cumul des responsabilités’*), which is set out in VI.–1:103 (Scope of application). Even at the level of the law governing the exclusion and restriction of liability, this demands a greater synchronisation of the two regimes than would be necessary had these model rules proceeded on the basis of the opposing principle of mutual exclusivity of contractual and non-contractual liability (*‘non-cumul des responsabilités’*).

Illustration 2

Where a person leaves a suit at the cleaners and it is returned damaged, (where there is negligence as to its cleaning) there isn’t only a claim for damages for non-performance of a contractual obligation, but also a claim for damages under the law on non-contractual liability. Where and in so far as it is possible in such cases to limit the contractual liability to a pre-agreed multiple of the amount to be paid for cleaning a suit, it must also be possible to come to a corresponding agreement for parallel liability under this Book; the agreement to restrict liability would be pointless otherwise.

Exceptions. However, no Member State’s legal order (nor Community Law) handles the law on the exclusion and restriction of non-contractual liability without having a large number of exceptions to the principle of freedom of contract. After long and controversial discussion, VI.–5:401 strives for a middle ground, which (as with the law on liability without negligence or intention, above; see VI.–3:207 (Other accountability for the causation of legally relevant damage)) partially operates with references to the respectively applicable national law. The principles are as follows. (i) An exclusion or restriction of non-contractual liability for damage should generally not be permitted if it relates to the intentional causation of legally relevant damage of any type. (ii) An exclusion or restriction of liability should likewise not be permitted if it relates to grossly negligent causation of legally relevant damage and if either

the latter consists of personal injury or, where other types of legally relevant damage occur, the exclusion would be illegal or immoral. (iii) Producers' liability for damage caused by a defective product under VI.-3:204 (Accountability for damage caused by defective products) cannot be excluded or restricted. (iv) Although, in all other cases, the general principle of freedom of contract prevails, it remains subject to statutory limitations in the applicable national law. In this way paragraph (4) provides room for certain "isolated solutions" to regional and precisely defined sectors of the law on liability. Conversely, paragraph (2)(b) contains a special rule applicable only to damage caused by gross negligence and to this extent grants the law of contract precedence over the law on non-contractual liability.

B. No exclusion of liability for damage caused intentionally (paragraph (1))

Policy considerations. Paragraph (1) contains a rule which is widely regarded as axiomatic: agreements waiving liability in the case of future intentional damage are essentially the prototype for an immoral contract, since this boils down to rendering oneself defenceless against another. Agreements with such content are invalid, regardless of the type of damage.

Employers' liability. Paragraph (1) does not rule out the situation in which an employer excludes or restricts liability for eventual intentional wrongs on the part of personnel, e.g. for thefts. If contained in standard terms, however, usually such an exclusion or restriction of liability will fail under the fairness test and, in relation to physical injury already falls under II.-9:411(1)(a) (Terms which are presumed to be unfair in contracts between a business and a consumer).

Line of demarcation with consent and acting at own risk. The impossibility of contracting out of subsequent liability for the intentional infliction of damage does not affect the defences of consent and acting at own risk (see VI.-5:101 (Consent and acting at own risk)). The difference lies in the fact that consent relates to a concrete event and acting at own risk pertains to an occurrence which by its nature is foreseen, while the exclusion of liability for intentionally caused damage would include acts that do not remain within the context of something agreed in advance between the injuring person and the injured person.

C. Exclusion of liability in cases of gross negligence (paragraph (2))

Personal injury (sub-paragraph (a)). In accordance with the position adopted in an overwhelming number of European legal systems, and in line with the policy of placing a high value on protecting body and health, paragraph (2)(a) rules out the exclusion of liability for personal injuries caused by gross negligence. In any event, the rule only has significance for individual agreements; in standard terms between businesses and consumers, every term in a contract is presumed to be unfair if it "excludes or limits the liability of a business for death or personal injury caused to a consumer through an act or omission of that business", see II.-9:411 (Terms which are presumed to be unfair in contracts between a business and a consumer). Both rules ensure that the rights of dependants and (in the case of fatal injuries) the surviving dependants are immune from a contractual exclusion of liability.

"Gross negligence". Paragraph (2) does not explicitly invoke the concept of "gross negligence" as such. Instead it provides an immediate definition: gross negligence consists of a profound failure to take such care as is manifestly required in the circumstances.

Other types of legally relevant damage (sub-paragraph (b)). Where damage of another type is at issue (e.g. damage to property), an exclusion of liability for causing such damage through gross negligence is invalid where it is illegal or offends against the precepts of good

faith. Hence, paragraph (2)(b) is linked to the rules in II.–7:301 and in II.–7:302 (Infringement of fundamental principles or mandatory rules) and refers to the rules of the applicable contract law. An exclusion of liability for property damage caused by gross negligence is thus impossible where the national applicable national law stands in opposition to it, e.g. because the law governing the exclusion of liability deals with intention and gross negligence in principle in the same way. Alongside this, VI.–5:401(2)(b) is based on whether, under the circumstances of each individual case, it is to be deemed an offence against the principle of good faith for a personally grossly negligent injuring person to invoke an equivalent contractual exclusion of liability. An implied waiver of liability is to be denied without exception in cases of gross negligence. A contractual exclusion of liability is in any case contrary to good faith even where the injuring person is reasonably insured against the risk of liability for causing damage through gross negligence.

D. Product liability (paragraph (3))

No contractual exclusion of liability. Paragraph (3) adopts the corresponding rule of the product liability Directive (Directive 85/374/EEC, art. 12). A contractual exclusion of liability for negligently caused damage to commercial property remains possible. This is not addressed by VI.–3:204(1) (Accountability for damage caused by defective products).

E. Paragraph (4)

Exclusion of liability in cases of ordinary liability in negligence. Paragraph (4) expresses the principle that a pre-emptive exclusion or restriction of liability is possible in all remaining cases. What is essentially involved here is the exclusion of liability in cases of ordinary negligence and the exclusion or restriction of liability without intention or negligence. In turn, II.–9:411 (Terms which are presumed to be unfair in contracts between a business and a consumer) is to be observed here. Liability for damage to body and health caused by slight negligence is also immune from being contractually excluded in standard terms. Of course, the same does not apply to liability without intention or negligence. This is because II.–9:411 requires an “act or omission” on the part of the business and this is lacking in the cases covered by Chapter 3, Section 2 (Accountability without intention or negligence). Where a person is liable without having “done something wrong”, that person is liable for neither a positive act nor an omission; but is liable regardless of conduct.

Unless contrary to statute. Also under paragraph (4), an exclusion or restriction of liability is invalid where such a contractual stipulation contradicts the applicable national law. Thus, these model rules leave room for regional statutory rules for individual fields of activity, e.g. for the prohibition of the contractual exclusion or restriction of vehicle owners’ liability or for a prohibition of the contractual exclusion or restriction of liability for certain professional groups that are subject to the duty to take out indemnity insurance and have arranged such insurance. In the Member States there is such a large spectrum of such “isolated solutions” specific to certain activities, for which various insurance practices and duties provide the basis, that it did not seem possible to reduce them all to a general concrete principle. An example of paragraph (4) from Community Law is to be found in Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods (OJ L 373/37 of 21 December 2004) art. 8(2), which provides: “Member States shall introduce into their national legal systems such measures as are necessary to ensure real and effective compensation or reparation ... for the loss and damage sustained by a person injured as a result of discrimination within the meaning of this Directive, in a way which is dissuasive and proportionate to the damage suffered. The fixing of a prior upper limit shall not restrict such compensation or reparation.”

Section 5: Loss within VI.–2:202 (Loss suffered by third persons as a result of another’s personal injury or death)

VI.–5:501: Extension of defences against the injured person to third persons

A defence which may be asserted against a person’s right of reparation in respect of that person’s personal injury or, if death had not occurred, could have been asserted, may also be asserted against a person suffering loss within VI.–2:202 (Loss suffered by third persons as a result of another’s personal injury or death).

COMMENTS

Aim. This Article contains the rule that every defence which is available to the injuring person against the directly injured person, may also be asserted against the latter’s dependants or surviving dependants (VI.–2:202 (Loss suffered by third persons as a result of another’s personal injury or death)). This corresponds to a consideration of justice that is widely acknowledged in Europe: where the injured person could not have brought a personal claim, or at any rate must bear a reduction of its extent, the same applies to the detriment of persons who derive rights from the injury or death of that person.

Examples. The Article pertains to every defence in this Chapter. Third party claims are e.g. excluded where the injured person validly consents to treatment or had participated in a team sport having accepted the risks. They are likewise ruled out where the person directly affected has been killed or injured in an emergency situation requiring self-defence or had validly agreed to a contractual exclusion of liability. Even contributory fault is not an exception. Where the injured person is ascribed half of the fault for the mishap, the claims of family members and surviving dependants are reduced to 50% of the amount of damages to which they are otherwise entitled.

CHAPTER 6: REMEDIES

Section 1: Reparation in general

VI.–6:101: Aim and forms of reparation

(1) Reparation is to reinstate the person suffering the legally relevant damage in the position that person would have been in had the legally relevant damage not occurred.

(2) Reparation may be in money (compensation) or otherwise, as is most appropriate, having regard to the kind and extent of damage suffered and all the other circumstances of the case.

(3) Where a tangible object is damaged, compensation equal to its depreciation of value is to be awarded instead of the cost of its repair if the cost of repair unreasonably exceeds the

depreciation of value. This rule applies to animals only if appropriate, having regard to the purpose for which the animal was kept.

(4) As an alternative to reinstatement under paragraph (1), but only where this is reasonable, reparation may take the form of recovery from the person accountable for the causation of the legally relevant damage of any advantage obtained by the latter in connection with causing the damage.

COMMENTS

A. Chapter six in overview

Reparation, compensation, prevention. This Chapter deals with the legal consequences of non-contractual liability. Section 1 provides rules for all forms of reparation. Section 2 provides special rules for the monetary reparation of damage (“compensation”). Section 3 addresses issues of damage prevention. Claims for the costs incurred in the prevention of imminent damage also fall under this Section. Section 1 applies in principle (i.e. as far as possible with due regard to the nature of the thing) to all remedies, Section 2 only to monetary damages, and Section 3 solely to the preventive protection of rights.

Overlap between reparation and prevention. In certain special cases there can be an overlap between reparation and prevention. Here the injured person can choose which of these remedies to claim.

Illustration 1

A man has sexually abused a minor for two years. Then he has the portrait of the boy tattooed on his chest. The boy claims the removal of the tattoo, which is a constant affront to his personal dignity. This claim is as much a claim in damages (VI.–6:101(1) and (2)) as a claim under VI.–1:102 (Prevention) in conjunction with VI.–6:301 (Right to prevention).

Relationship to Chapter 2. This Chapter applies only where the claimant has suffered legally relevant damage or where such damage is imminent. Chapter 2 states what legally relevant damage is. This Chapter is concerned with the liable person’s obligation to provide compensation for causing such damage. The answers to such questions as what is meant by “loss” are therefore to be found not in this Chapter, but in Chapter 2 (see e.g. VI.–2:101 (Meaning of legally relevant damage) paragraph (4), VI.–2:201 (Personal injury and consequential loss) paragraphs (1) and (2), and VI.–2:202 (Loss suffered by third persons)).

Substantive law, not procedural law. This Chapter deals exclusively with questions of substantive law. Matters relating primarily to procedure or enforcement are beyond the scope of application of these model rules (I.–1:101 (Intended field of application) paragraph (2)(h)). Rules on the assessment of damages are regarded for this purpose as being of a procedural nature, as are such questions as whether and to what extent appellate courts may review decisions taken by courts of first instance charged with establishing the facts.

B. The Article in overview

Aim and forms of reparation. The Article relates to the aim and forms of reparation. Paragraph (1) expresses the general principle that a person who is obliged to make reparation must reinstate the situation which would have existed if the event giving rise to liability had not occurred. This general principle applies to the type as well as the extent of compensation. The question of *how* the damage is to be made good is answered by paragraph (2), which

states that reparation must be made in a manner that best befits the type and measure of damage in the circumstances of the case. Paragraph (3) provides special rules on the amount of compensation payable where things are harmed and animals injured. Finally, paragraph (4) opens up the possibility of claiming the profit gained from the wrongful activity, instead of restoration of the previous situation.

C. Restoration of the previous situation (paragraph (1))

The principle of restitution in kind. The injuring event should be “undone” as far as possible by the obligation to provide damages. Therefore, in principle the injuring person has to restore the situation which would have existed had the harm not been occasioned. This is the principle of restitution or restoration in kind. *How* the original situation is restored is another question. It can be done in various ways. The injuring person can perform the necessary work, or commission a third party to do so or pay the injured person money, so that the latter can eliminate the damage, either personally or in turn through a third party commissioned to do so. Where the injured person undertakes the removal of the damage personally or has it done by another, the claim in damages is for the costs incurred.

Restitution in kind and full restitution. Restitution in kind indeed means restoration of the situation that would have existed were it not for the injuring event, but not necessarily restoration through the injuring person’s personal work or through the work of someone who is commissioned to do so. Damages in the form of the payment of money (compensation) can also be restitution in kind or be in furtherance of it. In this case the principle of restitution in kind has the task of contributing towards concretising the amount of money falling due. It is subject to the principle of full restitution: in the case of compensation the amount of money which is necessary for the complete elimination of the damage falls due, no less, but also no more.

Illustration 2

A is the owner of items of clothing specified for sale. B soils the goods. They can be cleaned; however, after they are cleaned, they are no longer suitable to be sold as new. The payment of cleaning costs does not provide total restitution for the damage; the overall loss in value is what is in fact to be compensated.

Illustration 3

The wooden floorboards in a house are damaged. It proves to be impossible to even partially repair them; the entire flooring must be re-laid. The owner must incur a “new for old” deduction; without such a deduction, the laying of completely new flooring would lead to an unjustified enrichment on the part of the injured person, in that it would exceed the target for full restitution.

No punitive damages. The punishment of wrongdoers is a question for criminal law, not private law. Under these model rules, punitive damages are not available. They are not consistent with the principle of restitution in kind or with that of full restitution.

D. Damages in money or by other means (paragraph (2))

General. Paragraph (2) concerns the question how reparation is to be made. The answer is: in money (“compensation”) unless another form of reparation (“reparation in kind”) is better suited to the nature and extent of the damage. While paragraph (2) does not expressly give normative precedence over other forms of reparation to monetary compensation, the provision of damages is still, purely “statistically”, the most reasonable form of reparation. In cases of

injuries to body and health - apart from minor wounds occurring in everyday life - every other type of reparation, practically without exception, is inapplicable and in cases of property damage or loss of property of another kind (e.g. as a consequence of false information) things are no different.

Reparation not in money. There are of course cases in which only a claim for reparation in kind (i.e. not in money) can carry into effect the basic principle formulated in paragraph (1). The claim in damages against a thief, for instance, is first and foremost directed at the return of the thing; if this were different, the practical result under the law on damages would be to aid and abet an obligatory sale of property. The main field of application of reparation in kind is without doubt the law on infringements of incorporeal personality rights. The retraction of a statement about another is a common example, but not the only one. Moreover such a retraction is often not sufficient to make good the damage. Paragraph (2) can therefore also justify the right to demand the publication by the injuring person of a corrective judicial decision in the same manner as the incriminating comments were published.

Forms of reparation not mutually exclusive. Damages are not necessarily always to be performed either exclusively in the form of a payment of money or in the form of reparation in kind; it may be that the damage suffered can only be completely removed by the payment of money *and* a certain *de facto* act.

Illustration 4

A construction company causes damage to the claimant's house and removes the damage using its own people. That does not change anything with regard to its obligation to pay the cost of renting a replacement apartment, into which the claimant must move until the repair work is finished.

E. Economic total loss (paragraph (3))

An exception to paragraph (1). It follows from paragraph (1) that the entire damage is to be compensated; as stated, the principle of full restitution applies. Where a thing is harmed and the necessary expense of repairing it exceeds its value, the question arises of what "full restitution" means in such a case. Under paragraph (1) it is arguable that it does not depend on the value but on the amount of the repair costs. This is because the protection of property rights also means that the integrity of concrete assets is protected and their restoration is only possible by the (albeit costly) repair of the damaged thing. In many situations, however, that would lead to the result that an unreasonable burden is placed on the liable person. Consequently, paragraph (3) limits the extent of reparation in accordance with the majority of the Member States' legal systems. Where the repair costs are disproportionately high in relation to the loss in value of the thing, compensation is restricted to the loss in value. It is not possible to give a single answer to the question of when the repair costs will exceed the loss in value in an unreasonable fashion. In the normal case, especially cases of vehicle damage, a scale of 30% may serve as a guideline, but that is nothing more than a general figure. Where things not only have a material value, but also a non-material value to the owner for understandable reasons, increased repair expenses may also be reasonable.

Animals. The second sentence of paragraph (3) provides an exception for animals, according to the purpose for which they are kept. Where normal production animals are at issue (e.g. a farmer's cows) the reparation falling due remains limited to their market value (plus a marginal amount in excess of that for veterinary treatment, as the case may be); in the case of domestic animals kept by families, such a limit does not correspond to the legally protected interest of the owner.

F. Recovery of profit instead of compensation of loss (paragraph (4))

Siphoning-off of profits. Not being concerned with reinstatement, paragraph (4) provides another exception to paragraph (1). It involves infusing into the law on damages the principle that the profits made from a civil wrong should not be retained by the wrongdoer.

Systematical issues. Paragraph (4) clarifies two systematical issues. The recovery of profits has not been assigned to the law on benevolent intervention in another's affairs nor solely to the law on unjustified enrichment. The law of benevolent intervention in these model rules is confined to genuine and justified intervention in and conducting of another's affairs (see V.–1:101 (Scope of application)).

Relationship to the law of unjustified enrichment. Paragraph (4) bears a very close resemblance to the situations that are the subject-matter of VII.–4:101 (Instances of attribution) sub-paragraph (c) in the Book on unjustified enrichment. That rule pertains to enrichments as a result of the interference with another's rights and interests, i.e. enrichments through actions, which usually constitute a civil wrong as well. VII.–4:101(c) indeed goes beyond the law on non-contractual liability to the extent that it denies a *bona fide* person the advantages of exploiting another's goods and interests and deems such a person liable to surrender the fruits even where and so far as the entitled party did not want to exploit the goods or interests personally and thus suffered no loss (or damage). Notwithstanding that, paragraph (4) seemed indispensable because although this provision has an unjustified enrichment "varnish", it is solely concerned with following the intrinsic logic of the law on non-contractual liability for damage caused to another. Potential wrongdoers are warned that there is no profit to be made from a civil wrong. Furthermore, paragraph (4) is intended to ease the burdens on the courts, sparing them from carrying out another, separate unjustified enrichment test in addition to the one under this branch of the law. In many cases the law of unjustified enrichment and the law on non-contractual liability through their separate means of reasoning will reach the same or at least similar results. This is because the cases dealt with here will usually concern people acting in bad faith and they will not only be liable under the law of unjustified enrichment for the fruits of the exploited benefit but will also not typically have the defence of disenrichment (VII.–6:101 (Disenrichment) paragraph (2)(b)). To the extent that the wrongdoer satisfies the claim under paragraph (4) of the present Article, concurrent liability under the law of unjustified enrichment is then extinguished (VII.–7:102 (Concurrent obligations) paragraph (1)(b)).

Commercial trademark rights and copyright. Paragraph (4) is of particular significance in the law governing the infringement of incorporeal personal interests worthy of legal protection. Under the law on liability for commercial trademark rights and copyright, the claim to recovery of profits has been particularly moulded by a range of special laws (see e.g. Directive 2004/48/EC of 29 April 2004 on the enforcement of intellectual property rights art. 13(1)(a)); the same is true for the law against unfair competition. These provisions are not affected by VI.–6:101(4); as long as they conclusively govern the subject-matter they enjoy precedence of application over the general law on non-contractual liability (VI.–1:103 (Scope of application) paragraphs (d) and (c)).

Right of choice. Paragraph (4) provides the injured person with a right to choose between a claim to reparation of the actual loss occasioned and a claim to the recovery of the injuring person's profit, i.e. another method of quantifying the claim to reparation due to the detriment suffered. The claim to recovery of the injuring person's profit proceeds from the fiction that the injured person would have been able to exploit the relevant rights in the same way and with more or less the same economic success as the injuring person. Only where such a fiction

is entirely inappropriate in the circumstances of the case can the court reject the exercise of the right of choice as abusive.

VI.-6:102: De minimis rule

Trivial damage is to be disregarded.

COMMENTS

Policy considerations. This Article provides that trivial damage does not lead to a claim for reparation or to a claim to preventive legal protection. The idea is that trivial damage must be accepted in highly civilised society as a socially acceptable interference not warranting reparation; and actions for damages should be prevented if they do not primarily involve making good a loss, but rather involve harming the other party through the burden of having to bear the costs of legal proceedings. The rule of leaving trivial damage without a corresponding claim to compensation can also prevent class actions or other collective actions in which ultimately it is only the lawyers who profit or the organisations to which the relevant rights to reparation have been assigned. Trivial damage remains trivial even where it is suffered by many simultaneously.

Trivial damage. On the issue of whether damage is trivial, economic considerations are not decisive, but rather the legally protected interests of those involved, the type of grounds for attribution and the other conditions of damage causation. It is not trivial where a child's old and almost economically worthless doll is destroyed or taken away, and it is also not trivial when the dog of an old lady living alone is killed; even if the amount of compensation in such a case were to be at the lowest level, it would not fall under the present Article as trivial damage. Intentionally inflicted damage can hardly ever be categorised as trivial. However, it would be trivial to complain about a medically notified and correctly carried out injection, solely because one is subsequently made aware of the fact that one had not been sufficiently briefed by the hasty nurse. The situation is of course different where a complication arises as a consequence of the injection: serious consequences of minor individual damage are not trivial. Minor inconveniences of everyday life are also socially acceptable and thus trivial: a banal infection (a head cold) that one contracts in a packed airport shuttle bus does not provide a basis for a claim in damages against the fellow passenger, entering a room which one inadvertently thinks is one's own guest room does not ground liability in damages for the infringement of another's privacy.

Products liability. *Departing from the Community law currently in force (Product Liability Directive art. 9(b)), VI.-3:204 (Accountability for damage caused by defective products) proposes to extend the strict liability of a producer in favour of consumers to damage to property which amounts to less than €500. This proposition does not contradict the tendency of VI.-6:102. Quite apart from the fact that losses of several hundred Euros are not, on any view, trivial, VI.-6:102 in no way depends on such quantifications.*

VI.-6:103: Equalisation of benefits

(1) Benefits arising to the person suffering legally relevant damage as a result of the damaging event are to be disregarded unless it would be fair and reasonable to take them into account.

(2) In deciding whether it would be fair and reasonable to take the benefits into account, regard shall be had to the kind of damage sustained, the nature of the accountability of the person causing the damage and, where the benefits are conferred by a third person, the purpose of conferring those benefits.

COMMENTS

General. This Article deals with the problematic question of so-called “equalisation of benefits” (*compensatio lucri cum danno*). It concerns cases in which the behaviour of the wrongdoer caused not only detriment to the injured person but also some (mostly) economic advantage, especially because third parties provided payment or are liable for such payment to the injured person due to the damage suffered. The question is thus always whether such advantages may be set off against the liable person’s obligation to pay damages or whether such a mitigation of liability is to be denied, with the result that the injured person (provided the wrongdoer is in a position to satisfy the claim) may be entitled to multiple payments by reason of the damage suffered. The answer is that in principle the latter holds true and a mitigation of liability only comes into the picture if it is fair and reasonable under the circumstances (paragraph (1)). Paragraph (2) lists the criteria that are important in the context of this fairness test.

Policy considerations. The basic rule (no set-off) seems to be substantively imperative due to the variety of insurance systems and provisions on sick pay resting upon the model that the insurer or a party performing a comparable service acquires the injured person’s rights against the injuring person in the amount of the performance rendered. Such an acquisition of rights would be impossible if the right to damages were to be reduced. Naturally, only an existing right can be assigned. In other words, the basic rule is required and confirmed by insurance law. However, it also follows from considerations of justice inherent in the present branch of the law. In principle, the acts of third parties benefiting the injured person are no concern of the liable person; the fact that others are looking after the victim does not free the liable person of personal responsibility.

Causation. It is a general prerequisite of the equalisation of benefits that there be a causal link between the injuring event and the subsequent advantage. The tighter this link is, the easier it is for an equalisation of benefits to come into focus; the looser it is, the more susceptible to exclusion such an equalisation becomes.

Illustration 1

Trader T’s claim is frustrated as a result of erroneous information as to the solvency of T’s customer (C) provided by the bank. C is insolvent. T’s claim against the bank is to be correspondingly reduced only where the bank can prove that it was solely the proceeds of reselling the delivery, the payment for which remained outstanding, that enabled C to satisfy another debt of long standing to T.

VI.-7:105. VI.-7:105 (Reduction or exclusion of liability to indemnified persons) remains unaffected by the present Article. The rule in VI.-7:105 does not involve issues of benefit equalisation, but provisions of national law, which channel the *de jure* liability to an insurer, a fund or another institution with the consequence that the originator of the damage does not

even come “face to face” with the liability in the first place. It is correct, however, that, at least in the economic result, this is close to an equalisation of benefits.

Several liable parties. Situations in which several persons are liable to the injured person under this Book for the same damage are to be strictly distinguished from the cases covered by the present Article. In cases of the former type a double payment of damages is ruled out without exception; this would constitute an unjustified enrichment. Therefore, the rule only applies to the case where, along with the damages to be satisfied by the injuring person, another advantage based on a different legal basis accrues to the injured person.

Case groups. Precisely speaking, two different basic fact situations are to be distinguished. In the first (and less frequent) case, the advantage is a direct consequence of the event giving rise to liability; in the second, compensation payments or other economic benefits accrue to the injured person from third parties.

Kind of damage. In both types of case, it is first of all the type of damage suffered which plays a role. This is because in the case of solely economic detriment and also in the case of property damage, an equalisation of benefits in relation to the material losses comes into play more frequently than in the case of bodily injury and death. This results from the fact that in the case of the latter, it would be cynical and anything but “fair and reasonable” to say that the loss of someone close had also brought with it monetary benefits. Furthermore, such benefits are normally to be deemed a consequence of certain provisions of the law of succession and family law, not as a consequence of the wrongdoer’s behaviour.

Examples. A textbook example of one situation in which an equalisation of benefits would exceptionally be seen as fair and reasonable, is the destruction of a house with the consequent discovery of treasure trove on the owner’s land. The following are more true to life:

Illustration 2

A lorry driver drives into the claimant’s house, which is so badly damaged that it has to be completely demolished. By this very occurrence, the piece of land goes up in value enormously; a new urban development plan allows economically far more attractive forms of development. The owner exploits this increase in value by auctioning off the piece of land on very beneficial terms. The claimant’s claim in damages is, as far as it concerns economic detriment, to be reduced according to the extent of the increase in value, perhaps even to zero. However, the non-economic damage of the claimant remains unaffected by this; the claimant did not vacate the house voluntarily, but merely made the best of the situation.

Illustration 3

An equalisation of benefits also comes into play if a vehicle has to be repaired over a lengthy period and there are savings as a result of the fact that there would otherwise be wear and tear on the vehicle during that time.

Illustration 4

A child is killed. The parents’ claim in damages for the non-economic damage they have suffered is not to be reduced by the argument that their nerves and finances, which would have been expended in raising the child, have been “spared”.

Illustration 5

A father, who financially supported his children's education, dies in an accident. The children's claim to compensation for their loss of maintenance is not to be reduced for the reason that, as a consequence of their father's death, they were able to inherit his estate earlier. As long as the accident was caused by neither intention nor appreciable negligence, it could however be fair if the considerable income from interest gained due to the prematurely inherited assets were to be counted as reducing the claim when calculating the level of damage due to loss of maintenance.

Nature of the accountability. In assessing whether an advantage accrued is to be set against liability, the basis of liability is also of great significance. In particular, there will be no reduction in liability where the liable person caused the damage intentionally.

Performance by a third party. Most issues in relation to a possible equalisation of benefits are raised in the context of benefits performed for the injured person by third parties by reason of the harm. Under paragraph (2) the result depends on the aim of these benefits, i.e. on whether alleviating the position of the injuring person was or was not an objective. In the normal case there will be no such purpose, which once more confirms the rule (no setting off). In special circumstances it can even occur that third party expenditure not only does not mitigate the liable person's obligation to pay damages but also increases it: see VI.–2:201(2)(a) (Personal injury and consequential loss).

Examples. As already stated, the most important examples relate to insurance payments to injured persons and continuation of pay by employers (to injured and therefore absent workers). Other examples are donations from third parties (not being participants in the causation of damage) and increased income as a result of a change in career necessitated by injuries sustained. Such benefits are generally not to be taken into account to reduce compensation. If there is no assignment by operation of law of the injured person's right to compensation, the injured person may effectively recover twice over. The position is different only where the aim of the contribution from the third party was also to benefit the injuring person. The other criteria of the fairness test also hold true in cases involving benefits from third parties, especially the rule that a wrongdoer who acted intentionally will in principle not be entitled to any relief.

Illustration 6

At a major football event a police officer from the host nation is beaten up and very severely injured by hooligans from a participating nation. There is extensive media coverage of the event. People from the country from which the hooligans come are ashamed of their fellow countrymen and donate large sums for the benefit of the police officer. This does not reduce the hooligans' liability.

VI.–6:104: Multiple injured persons

Where multiple persons suffer legally relevant damage and reparation to one person will also make reparation to another, the rules in Book III, Chapter 4, Section 2 (Plurality of creditors) apply with appropriate adaptations to their rights to reparation.

COMMENTS

Reparation to one person will also make reparation to another. This Article relates to a problem which arises relatively frequently in the law on non-contractual liability. It concerns

the question of who can claim damages (or as the case may be, who can claim which part of the damages) where the injuring person has inflicted a legally relevant damage on several persons and the making good of one of these damages results in the simultaneous reparation of all others; this meaning in turn that the injuring person must only satisfy the damages once in total. The most frequent case in practice is that of damaging a thing in which various different people hold a property right. The repair of the thing or the compensation of the necessary repair costs remedies the consequences of several separate legally relevant damages.

Illustration 1

B has purchased goods from S who enjoys a reservation of ownership. T damages this property negligently. Although there is legally relevant damage both to S's ownership and to B's property right in the goods (if such a property right, e.g. an *Anwartschaftsrecht*, exists under the applicable law), T is in any case never liable as regards the repair costs (the position will be different, for example, as regards an additional loss of income for B during the time of repair) for more than 100% of the expense.

Damage and damages. In these cases it is important as a first step to distinguish between determining the existence of a legally relevant damage for a given interested party and, on the other hand, the appropriate remedy which responds to that claim. VI.–2:206 (Loss upon infringement of property or lawful possession) is concerned solely with the ascertainment of a legally relevant damage. By contrast, the questions of (i) the mode, (ii) the quantum and (iii) the appropriate recipient of reparatory legal redress which may be claimed belong in the law of remedies. The present Article addresses the third of these questions. This provision does not, however, apply where the same conduct has caused several separate legally relevant damages *and* they can only be made good separately and independently from their counterparts.

Illustration 2

A operates a hairdresser's salon in a house which is damaged by T's lorry. Of necessity the business must be closed for a period. O, the owner of the building, and A have each suffered loss, O as a result of the infringement of his property right and A as a result of the infringement of her right to lawful possession of the salon. O has a claim to compensation for the repair costs; A has an independent claim to compensation for the loss of business income during the time in which it was not possible to operate the salon. The fact constellation required in VI.–6:104 is not present here.

Reference to Book III. The Article deals with the question by making reference to the rules in Book III, Chapter 4, Section 2 (Plurality of creditors). Within these rules, III.–4:202 (Solidary, divided and joint rights) distinguishes between these different types of right; III.–4:203 (When different types of right arise) paragraph (1) stipulates that whether a right to performance is solidary, divided or joint depends on the terms regulating the right, and paragraph (2) of the same Article provides that the default rule is that the rights of co-creditors are divided.

Significance for the rules in this Book. These basic rules also apply to situations which may arise in the law on non-contractual liability. In view of the variety of possible case constellations, a more precise rule could not be formulated. The point of departure may nonetheless be set down, namely that in principle the damages must accrue to the person who

in actual fact suffers a loss due to the property damage. This is because such a loss is a prerequisite for the fact that a person has suffered a legally relevant damage according to the rules of Chapter 2. The mere breach of a right is not sufficient for this except in those specific situations in which the very breach itself is expressly qualified as legally relevant damage.

Illustration 3

T, driving too fast, loses control of a lorry on a bend and damages a house owned by O. The land on which the building stands is burdened with a security in favour of the B bank. Both O and B suffer an infringement of their property rights. The quantum of loss in each case, however, depends on the circumstances of the particular case. Depending on the creditworthiness of O, the width of the security (i.e. whether it extends to O's right to reparation and any proceeds of it) and the extent of their (other) securities, the bank may suffer only a limited loss or perhaps none at all. In the latter case, despite the infringement of its property right, B suffers no legally relevant damage.

Illustration 4

The facts are the same as in illustration 1. If B performs the obligations under the contract with S, as agreed, and continues to pay the instalments of the price, a case of default does not arise. S has no loss; B alone is entitled to the damages. Things are different where at the time of the accident B has already stopped performing the obligations under the contract of sale. In case of doubt, B is entitled to the part of the claim in damages that correlates to the percentage of the cost price which has already been paid off and S to the other part. That is so, in any event, where the car is a total loss. Conversely, where lesser damage is involved, which can still be reasonably removed by repair, both of the injured parties are entitled as joint creditors to the claim to reparation for repair costs and the claims due to loss of use and loss in value of the now damaged car; this is in the case where the security interest matures. The issue of equalising the interests between them is an issue that should not burden the action for damages following from the accident. As a consequence, each creditor may only demand performance to both collectively (see III.-4:202 (Solidary, divided and joint rights) paragraph (3)).

VI.-6:105: Solidary liability

Where several persons are liable for the same legally relevant damage, they are liable solidarily.

COMMENTS

A. Solidary liability of multiple liable persons

Common European law. This Article expresses a rule which is part of every Member State's legal system and is also to be found in Community Law (primarily in Council Directive 85/374/EEC of 25th July 1985 on liability for defective products art. 5): if several persons are liable to the injured person for causing the same damage, they are solidarily liable. This rule has also prevailed (with some minor differences in the details) in a notable fashion where, under the wording of the legal authorities, another solution (separate liability) would have been more obvious.

Policy considerations. The principle formulated in the Article is justified by a range of policy considerations. Each of the liable persons has caused the entire damage and so is therefore liable to the victim for the reparation of the entire damage. It should not become a “defence” against the victim – so far as the economic result is concerned - that another person has also caused the same damage. The victim should not be expected to establish the respective shares of liability; this issue must be ironed out by the liable persons between themselves. It would be unfair to require the injured person always to sue each and every liable person and dispute with them all and it would be especially unfair to require the injured person to bear the risk of personal insolvency of one of the liable persons. The injured person should in fact have the option of pursuing the person from whom reparation can probably be obtained most quickly and most easily. Along with economic reasons (inability to pay), legal and tactical considerations may also play a role here. One claim might be more difficult to establish than another or it may seem desirable not to bring an action against a particular person, in order to remain free to call that person as a witness (e.g. the employee of the liable employer).

Terminology. The Article invokes the terminology of III.–4:102 (Solidary, divided and joint obligations), which states: “An obligation is solidary when each debtor is bound to perform the obligation in full and the creditor may require performance of any of them until full performance has been received”. The present Article provides an answer for one situation for the purposes of III.–4:103 (When different types of obligation arise) paragraph (1) and simultaneously establishes the principle of solidary liability of several liable persons in the law on non-contractual liability. Furthermore, the present Article is confirmation of the general rule in III.–4:103 (When different types of obligation arise) paragraph (2), second sentence, according to which the liability of several persons for the same damage is solidary in cases of doubt.

Scope of application. The Article covers all cases in which at least two persons are responsible for the same damage under the rules of this Book. “The same damage” may relate to only a part of the overall loss of the victim. The Article then applies to this part. The basis of the liability of the individual liable persons plays no role in relation to the injured person. Accessories are just as liable under solidary liability as accomplices, and as persons whose contribution to the chain of causation is presumed under VI.–4:103 (Alternative causes) and who cannot rebut this presumption. It is possible for liability due to a positive act and liability due to an omission to converge; the same goes for fault-based and strict liability (e.g. in the case of liability of employees and employers), and in the same way it can happen that two bases of strict liability may concur and ground solidary liability.

Illustration

At 5.30 am, horses of different owners are standing out on a dark roadway. The horses have broken out of their paddock. A man rides into the group of horses on his motorbike and is fatally injured as a result. Through hair follicles from a mare and a gelding found on the motor bike, forensic scientists can identify the owners of the two horses. The two owners are solidarily liable to the widow.

B. Internal allocation of liability

III.–4:106 (Apportionment between solidary debtors). VI.–6:105 does not deal with the internal allocation of liability between the solidarily liable parties. This is already adequately dealt with in III.–4:106 (Apportionment between solidary debtors). Paragraph (2) of that Article sets out the basic rule that in their internal relationship each of the co-debtors is burdened with the same share of the debt. However, superimposed on that basic rule is a

reasonableness test. Deviations from liability in *per capita* shares may be justified for a multitude of reasons which are not susceptible of being comprehensively listed. From the point of view of the law on non-contractual liability the most important factors are the extent of the fault of the participants and the extent of the realisation of a danger for which Chapter 3, Section 2 of this Book imposes strict liability. However, contribution between the debtors may also be affected by matters which are not related to the law on non-contractual liability – in particular those which derive from a contractual relationship between the co-debtors. It may be, for example, that a person has contractually agreed with an owner to keep the latter's building safe. In such a case the contractor alone will be liable in a question with the owner. As regards contribution between an employer and an employee in cases in which both are liable as solidary debtors to a third party, VI.–7:204 (Liability of employees, employers, trade unions and employer's associations) applies. Questions relating to employment law are not addressed by this Book.

VI.–6:106: Assignment of right to reparation

The injured person may assign a right to reparation, including a right to reparation for non-economic loss.

COMMENTS

General. This Article provides that non-contractual rights to reparation are freely assignable (and hence, depending on the applicable law of succession, also transmissible on death to heirs or successors). There is no exception for rights to the reparation of non-economic loss. From the perspective of the law on non-contractual liability for damage, it is not necessary that the right has been made the subject of a court action or recognised by the liable person before the death of the injured person; it is not even necessary that the injured person clearly declared a wish to pursue the claim if in a position to do so. In contrast, a valid waiver of the right to damages brings about its extinction; in the absence of an existing right, there is no room for assignment or succession.

Policy considerations. The ability to assign (and with it to bequeath) rights to reparation for economic damage is for the most part unproblematic. More heated policy debate continues to centre on the ability to assign or bequeath rights to reparation for non-economic loss. This Article adopts the position that such rights should not be treated any differently from rights to reparation for economic loss. This corresponds to the equation – in principle – of economic and non-economic damage, which finds expression in VI.–2:101 (Meaning of legally relevant damage) and it is in conformity with the majority of legal systems and the trend of more recent statutory law-making.

Moral reservations obsolete. Earlier moral reservations against such a rule should nowadays be regarded as obsolete. It would unreasonably diminish the legal position of the surviving injured person if that person could not personally decide upon the means of realising the rights held. Conversely, the issue of the ability to bequeath a right to compensation for non-economic losses is indeed in principle an issue of the law of succession and as such not the subject-matter of these model rules (I.–1:101 (Intended field of application) paragraph (2)(b)). However, where the applicable law of succession is built on the principle that only those rights can be bequeathed which can be transferred in one's lifetime (thus are not of a highly personal nature and therefore do not disappear upon the death of their holder), VI.–6:106 also has an indirect effect in succession law. This is desired. There is little force in the argument that the law should not allow third parties (especially the heirs) to be "enriched" by the

suffering of the deceased. The sole concern here is the post-mortem realisation of interests which the person concerned was not able to realise while alive: a dying person should at least be aware that the law will not close its eyes to the pain endured in the fight for life.

Assignability in specific cases. The Article leaves it to the injured person to decide how to realise a right to damages; it need not necessarily be exercised personally, but can be sold or donated. This applies to rights to damages of all types, even those directed at compensating for the loss of a right which would not have been assignable itself. Such a case is conceivable e.g. in the situation set out in VI.-2:202 (Loss suffered by third persons as a result of another's personal injury or death) paragraph (2)(c): the fact that the right to maintenance in question may not have been assignable under the applicable law does not mean that the right to damages for its loss should be unassignable. That may also be justified by the fact that reparation will itself often take the form of lump sum compensation and that the corresponding right should not be less freely available than a lump sum already paid.

Section 2: Compensation

VI.-6:201: Injured person's right of election

The injured person may choose whether or not to spend compensation on the reinstatement of the damaged interest.

COMMENTS

General. The rules of Section 2 of this Chapter relate only to monetary damages ('compensation', see VI.-6:101 (Aim and forms of reparation) paragraph (2)). This Article begins with a clarification: the fact that damages are intended to restore the circumstances that would have prevailed had the event causing damage not occurred (see VI.-6:101 (Aim and forms of reparation) paragraph (1)), should not lead to the inference that a sum of money received for the reparation of the damage must be actually invested by the injured person in the restoration of the previous state.

Property damage. The Article relates primarily to property damage. The injured person can claim the cost of repair even if having no intention of repairing the damaged thing or having it repaired. The injured person is freely entitled to invest the money received for the reparation of the damage in another way. However, if the repair is not carried out then no value added tax falls due; the reparation of VAT which might have been payable had there been an actual restoration is consequently unnecessary.

Other cases. So too, in other cases neither the court nor the liable person may dictate to the injured person how the compensation is to be used. Furthermore, the award of damages may not be made subject to a condition that it be used in a certain specified way. Depending on the applicable procedural law it may indeed be possible that, *upon application* by the claimant, the court orders payment directly to a third party (e.g. in the case of the infringement of the personal dignity of a well-known politician who requests that the compensation due for non-economic losses be transferred by the liable person directly to a named charity); however, such a decision may not be made against the will of the claimant.

VI.–6:202: Reduction of liability

Where it is fair and reasonable to do so, a person may be relieved of liability to compensate, either wholly or in part, if, where the damage is not caused intentionally, liability in full would be disproportionate to the accountability of the person causing the damage or the extent of the damage or the means to prevent it.

COMMENTS

A rule subject to policy debate. The reduction clause contained in this Article is a particular bone of contention in the Member States. Opinion is divided. The idea behind the reduction clause has as many resolute supporters as it has adversaries. It is rejected in systems which hold that the extent of damages should depend only on the extent of the damage suffered; it is supported in systems which hold that the basis of liability can also play a role in the assessment of the reparation to be made, where this appears to be fair and reasonable in the circumstances of the individual case. The Article follows the latter approach.

No reduction of liability where damage is intentionally inflicted. Where damage is intentionally inflicted, a reduction of liability under this Article is excluded. This is in line with the general convictions of all Member States' legal orders.

Grounds for and prerequisites of a reduction of liability. In all remaining cases a policy decision is ultimately required between the two alternatives. The deciding ground for the solution chosen here is mentioned in the Article itself. Such abnormal discrepancies between the basis of liability and the extent of the damage may arise as to make it seem intolerable to let the liable person bear liability for the entire damage. There should therefore be an instrument available to allow a final check of the decision against general considerations of justice and fairness. This is mainly significant where a slight oversight or a technically negligent but morally unobjectionable act leads to damage, the reparation of which would disproportionately burden the injuring person, there being other possibilities for reparation open to the injured person. The rule can play a role in certain emergency situations requiring self-defence and it may also be the only way of achieving a reasonable result in cases coming under Chapter 3, Section 2 (Accountability without intention or negligence).

Illustration 1

Children aged eight and nine are playing in the barn of a farm. They light a "campfire"; the entire premises are burnt down, after hay stored nearby caught fire and the children had fled in panic. The insurer, to whom the farmer's claim in damages is assigned, sues the children personally, in order to be able to execute the judgment as soon as they (many years later) begin gainful activity. As long as the parents' indemnity insurance does not have to step in, until their middle age the children would have no prospect of earning more money through personal initiative than the limit set for them that is free from whatever form of execution is used by the insurer. Their lives would be ruined before they have even begun. A reduction of the extent of their duty to render compensation is fair and reasonable.

Illustration 2

A water pipe bursts in A's apartment. As a result, a very valuable archive in B's apartment (directly below A's) is damaged. B had specifically insured the archive with his household insurance. The liability of A is to be reduced so that the discrepancy between the grounds of liability (A could not have discovered the fault and is thus

liable only under VI.–3:202 (Accountability for damage caused by the unsafe state of an immovable)) and the extraordinary risk of damage can be balanced out.

The reduction clause in the overall system of these model rules The Article also helps usefully to reduce the distinctions between contractual and non-contractual liability. III.–3:703 (Foreseeability) restricts the extent of damages for non-performance of a contractual obligation to the foreseeable loss of the other party. The law on non-contractual liability does not have a corresponding rule. The resulting differences are, however, diminished by VI.–6:202, so that it becomes less significant whether certain conduct between contractual parties is at the same time to be qualified as a civil wrong giving rise to non-contractual liability. There is also a reduction clause in the rules on benevolent intervention (see V.–2:103(2) (Obligations after intervention) and V.–3:104 (Reduction or exclusion of intervener’s rights)) and it diminishes the importance of VI.–7:105 (Reduction or exclusion of liability to indemnified persons), a provision, which, *inter alia*, refers to legal orders which provide that private persons are not liable for property damage caused through negligence in so far as the injured person is indemnified by an insurer.

Scope. The Article covers all non-intentionally caused damage. It is therefore applicable not only in the context of liability for negligence, but also in the context of strict liability. In this latter area the availability of such a reduction mechanism can be particularly important if reasonable solutions are to be possible.

Illustration 3

While an aeroplane is landing, X’s messenger pigeons get caught in the air duct of the propellers. The owner of the aeroplane claims compensation from X, as the keeper of the pigeons, for the damage, which amounts to several hundred thousand Euros. It would be inequitable to allow X - who is not insured against such cases - to incur unlimited liability even for the portion of the damage remaining after the application of VI.–5:102 (Contributory fault and accountability) paragraph (4). As long as X was not negligent, X’s liability is to be reduced to zero.

Extent of the reduction. Illustration 3 shows not only that in exceptional cases a reduction of liability to zero is possible under this Article, but also that the formulation “liability in full” means “reparation, so far as due”. In other words, even liability which has already been reduced for other reasons (such as contributory fault) can be reduced again under this Article.

VI.–6:203: Capitalisation and quantification

(1) Compensation is to be awarded as a lump sum unless a good reason requires periodical payment.

(2) National law determines how compensation for personal injury and non-economic loss is to be quantified.

COMMENTS

The Article in overview. This Article relates to two different issues. Paragraph (1) provides that damages are in principle to be paid as a lump sum. Payment in the form of an annuity is to be exceptional and is to require special grounds. Paragraph (2) clarifies that this Book does not deal with the actual quantification of monetary damages in the case of personal injury and non-economic loss: that is left to national laws.

Paragraph (1). Monetary damages have as their purpose the restoration of the circumstances which would have prevailed if the event causing the damage had not occurred. In the normal case, viewed statistically, this purpose is best served by the payment of damages in the form of a lump sum. This has the beneficial side-effect that no protracted legal relationship persists between the injuring person and the injured person, during which new difficulties arising could be used as a reason for new conflicts and further court proceedings. In the case of property damage and damage to other assets there is therefore practically no alternative to the payment of damages by way of a lump sum. This is also true for damages for the reparation of lost profit, or losses flowing from a misguided investment and a decrease in turnover.

Good reason. The situation is different in the case of death or personal injury. In cases of this kind every European legal system provides for the possibility of ordering the liable person to make recurring periodic payments; most systems even prefer annuity payments as the general rule in this type of case and therefore require a good reason for ordering payment of a one-off lump sum. Apart from tax aspects, which can sometimes play a role, the main consideration in favour of granting annuity payments is that in cases of death or personal injury they are better suited to ensuring (as far as possible) the maintenance of the quality of life enjoyed before the accident. This is because a lump sum can often not protect against the danger of future underprovision; money is fleeting and is subject to the risk of inflation. Furthermore, the damage to be made good is often the loss of a regular periodic income and precisely this loss is then to be compensated for under the general rules of VI.-6:101 (Aim and forms of reparation) paragraph (1). This is particularly apparent where the damage in question is the death or disabling injury of a person who provided the claimant with maintenance, see VI.-2:202 (Loss suffered by third persons as a result of another's personal injury or death) paragraph (2)(c). The question whether there is a good reason for ordering the wrongdoer to make periodic payments is decided by the court; to this extent it does not depend on an agreement of the parties. Of course they are always free to contractually agree on the amount of damages and methods of payment.

Heads of compensation. The payment of an annuity may be useful not only for the compensation of economic damage. In the case of severe personal injury this mode of reparation may also be appropriate in relation to continuous non-economic losses. A combination of both types of damages is possible, e.g. a basic lump sum and subsequent annuity payments. The duration of periodic payments is geared according to the extent of the damage suffered; the frequency (usually every month) is set by the court. Conversely, in the case of an infringement of incorporeal patrimonial rights there will only rarely be a good reason for not using a lump sum.

Procedural issues. This Article does not deal with questions of a procedural nature. In particular, it does not deal with the issue of whether a non-contractual claim in damages must be litigated once and for all or whether, in the interests of minimising the risk associated with bringing proceedings, a claimant is permitted to claim only a partial amount of the entire damage and then claim the rest before the court when the preceding action has been won.

Paragraph (2). This Book also makes no statement on the issue of whether in the case of personal injury fixed sums of money are to be set as reparation for individual injuries (e.g. for the loss of one's right arm) or disadvantages (e.g. for each day which the injured person had to spend in bed) or whether in these cases an individual quantification of the monetary compensation is to be carried out. This Book likewise refrains from addressing the problem of whether for the case of the infringement of non-economic personal rights, a minimum

monetary sum for the reparation of the non-economic damage is to be set (see, however, comments under VI.–6:204 (Compensation for injury as such)). It also abstains from proposing an approach to the very variable high sums of money awarded for the compensation of non-economic loss. It seemed just as impossible to submit precise proposals for the quantification (in table form) of compensation of biological damage (see VI.–6:204 (Compensation for injury as such)). The question of whether such tables of damages are desired at all was not discussed. They are established practice in many countries, in some even statutorily set out; by contrast, in others they are strictly rejected. Even if an understanding had been achieved on such tables for certain issues, the specification of figures would have been impossible. Paragraph (2) of the present Article also counts compensation for bereavement among non-economic losses. The basic decision of this Book not to make provision for punitive damages remains untouched by this rule.

VI.–6:204: Compensation for injury as such

Injury as such is to be compensated independent of compensation for economic or non-economic loss.

COMMENTS

Injury as such. This Article is a corollary to VI.–2:201 (Personal injury and consequential loss) paragraph (1) and VI.–2:203 (Infringement of dignity, liberty and privacy) paragraph (1). In both of these Articles (and, under certain conditions, in VI.–2:101 (Meaning of legally relevant damage)), certain injuries are qualified as legally relevant damage even where they have caused neither economic nor non-economic loss. Violations of bodily integrity or injuries to a person's health or incorporeal personality rights are already as such legally relevant damage; it is not just (as is otherwise the case) the loss flowing from them which counts as legally relevant damage. These rules only take effect in conjunction with the present Article. "Injury as such" is to be compensated not only where there is an absence of any economic or non-economic loss, but also where the injured person also suffered such losses. In the latter case compensation for the injury as such will be independent of and additional to compensation for those losses.

A new concept. A rule in this form is not found in any national civil code or other national legislation. Its substance, which has been essentially adopted from Italy, is however recognised in the laws of several Member States and in others enjoys increasing acceptance. Frequently the courts act upon this idea even without an express statutory basis. In some legal systems minimum thresholds of liability laid down by the law fulfil the same function, at least in the field of the infringement of incorporeal personality rights.

Section 3: Prevention

VI.–6:301: Right to prevention

(1) The right to prevention exists only in so far as:

(a) reparation would not be an adequate alternative remedy; and

(b) it is reasonable for the person who would be accountable for the causation of the damage to prevent it from occurring.

(2) Where the source of danger is an object or an animal and it is not reasonably possible for the endangered person to avoid the danger the right to prevention includes a right to have the source of danger removed.

COMMENTS

Prevention is better than cure. This Article is a corollary to and a concretisation of VI.–1:102 (Prevention). Both rules must be read together. The underlying idea is that someone faced with imminent damage must be able under the law on non-contractual liability (and not only if the requisites of other branches of the law, for instance the law of property, are satisfied) to take positive action to prevent the damage from happening. Prevention is better than cure. Moreover a person who simply lets the damage happen and then claims reparation may be exposed to a plea of contributory fault and consequently to a reduction of compensation.

Forms of prevention. Damage prevention can take various forms. The person under threat can resort to self-help and then try to recover the costs from the person responsible for the threat (see VI.–6:302 (Liability for loss in preventing damage)). Alternatively, the person under threat can require the person responsible for the threat to remove or neutralise the source of danger. This latter type of claim is the subject-matter of this Article. (On the relationship to VI.–5:202 (Self-defence, benevolent intervention and necessity) see the Comments under VI.–1:102 (Prevention)).

Paragraph (1). The right to oblige another to perform a positive act in order to protect the interests of the claimant can only exist within certain narrow borders; otherwise, it would lead to intolerable restrictions of personal freedom. This is to be weighed up against the security interests of potential injured parties and in doubt takes priority over the latter. Therefore, it is not only required (in VI.–1:102 (Prevention)) that the claimant is under threat of imminent danger but it is also made clear that the claimant is entitled to claim positive action to prevent the damage only where a subsequent claim for damages would not be a sufficient remedy and where it is reasonable to impose the burden of removing the source of damage on the other person. The right to become *personally* active in the prevention of damage and then claim the costs incurred from the other party remains unaffected by this. Its requisites are dealt with in VI.–6:302 (Liability for loss in preventing damage).

Reparation not an adequate remedy. Whether reparation, especially monetary reparation, is a sufficient alternative remedy, depends on the circumstances of each individual case. First and foremost, it depends on whether damage irreparable by other means is imminent, on the type and measure of the imminent damage, on how high the probability of its materialisation seems to be from a factual and a legal perspective and whether the other person will be in a financial position to repair it.

Illustration 1

Neighbour X has built a swimming pool on her land. After it has been filled, the swimming pool starts to leak; the escaping water causes damage in the garden of Neighbour Y. Along with monetary reparation the latter requests precisely described measures for repair so that such an occurrence cannot recur. However, under the

circumstances of the case the risk that another water leak will occur is rather slight. A right to have specific repairs carried out has not been established.

Illustration 2

Politician P requests Publishers A to stop the printing of a publication that contains information on P damaging to his reputation. Due to the short time span, it is not possible to check to a sufficiently precise degree whether A has a defence at his disposal; in particular it is unclear whether the requisites of VI.–5:203 (Protection of public interest) are met. P does not have a claim under VI.–1:102 (Prevention).

Illustration 3

The facts are the same as in illustration 1 under VI.–6:101 (Aim and forms of reparation). The abused boy can also request of his abuser that he not appear in public with a naked torso until the removal of the tattoo. During this period, monetary reparation would not be a sufficient remedy.

Paragraph (2). Paragraph (2) ensures freedom of activity for those persons who might potentially occasion damage. The abatement of the source of danger through positive action may be claimed only where it does not burden the potential injuring person unreasonably. A cricket club may only be required to fence in the playing field for the purpose of protecting the neighbourhood from “flying balls” to a degree which guarantees stability against collapse in case of a storm and does not unreasonably burden the club financially; anything else would amount to banning the game of cricket completely. The remaining risk must be borne by the neighbours. The manufacturer of a certain product may not be compelled by ultimate consumers to carry out certain improvements to the product, in order to mitigate the risk of damage; the producer must be left the freedom to decide on suitable measures. This even applies where the claimant wants the product for personal or professional reasons. In contrast, it is reasonable for a house owner to be required to secure loose roof tiles which are in danger of falling on to a neighbour’s land. The measure is simple, there is no sensible alternative and it is directed at a precisely defined class of persons, whose fear of considerable harm is justifiable (consequently, it would be unreasonable if every random street user were able to pester the owners of the adjacent houses with the argument of being under threat when passing the house).

VI.–6:302: Liability for loss in preventing damage

A person who has reasonably incurred expenditure or sustained other loss in order to prevent that person from suffering an impending damage, or in order to limit the extent or severity of damage suffered, has a right to compensation from the person who would have been accountable for the causation of the damage.

COMMENTS

Fundamentals. A person, who is active in averting imminent damage in a reasonable manner or restricting its extent is exercising a right under VI.–1:102 (Prevention) and therefore has a right to reparation of the costs incurred. This basic rule is affirmed in every Member State. It is also an indirect consequence of VI.–5:102 (Contributory fault and accountability). This is because VI.–5:102 is based on the idea that a person who has not looked after his or her own affairs with sufficient care may not request full reparation. Conversely, a person who actually does look after the preservation of his or her goods and interests when they are threatened by

another person must then be able to claim reparation for the costs of doing so. They have been ultimately caused by a danger for which the other person bears responsibility.

Systematic significance. Beyond its material content, this Article in fact has inherent systematic significance. With its insertion into this Book, the character of the rule as part of the law on non-contractual liability is underscored. What is involved here is not a rule which belongs in the law of benevolent intervention in another's affairs or one whose results could also be achieved with the instruments of this branch of the law. This is because a person who makes expenditure for the avoidance or mitigation of personal damage does not act or in any case does not primarily act for the purpose of benefiting the potential injuring person (see V.–1:101 (Intervention to benefit another)); the person in fact wants to help himself or herself. VI.–6:302 has further significance for the general rule of causation in VI.–4:101 (General rule): the intervention described in VI.–6:302 does not break the chain of causation between the conduct of the potential injuring person and the loss (which in this case lies in the expenditure incurred to avoid an otherwise threatening damage). The present Article is to be distinguished systematically from VI.–2:209 (Burdens incurred by the state upon environmental impairment) by the fact that under the present Article a damage within the meaning of Chapter 2 must not yet have arisen; by contrast, VI.–2:209 (Burdens incurred by the state upon environmental impairment) clarifies that the expenditure (which is more precisely described therein) constitutes a legally relevant damage.

Illustration 1

P parks her vehicle directly in front of the entrance to G's garage and goes off to a hairdresser's. G needs the use of his car. After inquiring at neighbouring properties without success as to the whereabouts of the person in charge of P's vehicle, G telephones a recovery service which tows P's vehicle across to the opposite side of the road. The costs of this undertaking are less than if G had hired a taxi or a rented car in order to reach the distant airport from which G is due to fly. G cannot demand compensation under the rules of benevolent intervention in another's affairs because he acted predominantly in his own interest and was not acting in pursuit of a paramount public interest. However, he does have a claim to compensation under VI.–6:302. By acting as he did G has avoided a loss resulting from an infringement of his property rights. Whether P was agreeable to the measure or not plays no role.

Reasonably incurred expenditure. The expenditure incurred must be reasonable in relation to the threatened damage. Therefore, it is limited to the amount which would have resulted in damages, had the damage actually arisen or been exacerbated in the manner feared. The right to compensation does not however depend on the success of the measures taken. VI.–6:302 consciously follows the formulation in V.–3:101 (Right to indemnification or reimbursement). There as here, all that matters is that a reasonable neutral observer would have acted as the claimant did under the circumstances. If the claimant acted carelessly in the course of a reaction which in itself was sensible and reasonable then it may be that the claim will fall to be reduced under the rules on contributory fault.

Illustration 2

Upstream, large quantities of water plants up to 12 metres long are cut-back and simply thrown into the water by a company responsible for the maintenance of clean waters. They float downstream to an aqueduct connected to a hydroelectric power station, threatening to block it. The company which operates the station removes these plants. While it cannot base its claim for reparation of the costs incurred on the

argument that it benevolently intervened for the maintenance company, it has a good claim under VI.-1:102 (Prevention) read with the present Article, if the company would have been liable in negligence for the imminent (considerable) damage.

Illustration 3

An abnormally large, long and recognisably unsound tree on X's land falls down, knocking over electrical power lines on its way down. The power lines supplied electricity to a drying facility for tobacco on the neighbouring land. In order to limit the extent of the damage, the company operating the drying facility arranges for the installation of provisional electric cables. Along with the damages for the tobacco rendered unusable and for the destroyed cables, it is also entitled to reparation for the costs of the provisional solution.

Illustration 4

In a poster campaign, an advertising business, X, created the impression that a competitor would work together with it under its direction. In reality, the competitor had ended the co-operative work a long time ago due to a dispute and had prohibited X from using its name. At the same time as bringing an action, the competitor placed advertisements in several daily newspapers in which it corrected X's misleading indications. It did this because it had been constantly quizzed about X's advertisement at a conference of all the advertising businesses in the country and loss of turnover was imminent; customers' reactions had been so emphatically negative that a slow-down of orders had become highly likely. The requested judgment would have been granted even if the advertisements had not been published in time to be able to effectuate prevention. The competitor can claim reparation from X for the costs of the advertising campaign, which were reasonable.

CHAPTER 7: ANCILLARY RULES

VI.-7:101: National constitutional laws

The provisions of this Book are to be interpreted and applied in a manner compatible with the constitutional law of the court.

COMMENTS

Chapter 7in overview. Chapter 7 provides ancillary rules, which essentially clarify that certain legal issues in the field of non-contractual liability are not the subject matter of these model rules. The interaction of these matters with the law on non-contractual liability is partially too complex and also partially too sensitive from a policy perspective to be able to pronounce on them in model rules. Therefore, issues of the involvement of constitutional law - especially fundamental rights - in the law on non-contractual liability remain out of the equation (VI.-7:101). Further, the model rules of this Book do not themselves define the term "statutory provisions" (VI.-7:102) (Statutory provisions), they are silent on questions on the liability of the State (VI.-7:103) (Public law functions and court proceedings), do not probe into labour law (VI.-7:104) (Liability of employees, employers, trade unions and employers associations) and do not pronounce on issues that result from the interplay between insurance law and the law on liability (VI.-7:105) (Reduction or exclusion of liability to indemnified persons). In so far as they do not already fall outside the subject field of the model rules due

to I.–1:101 (Intended field of application), of course other matters are intentionally not enumerated in Chapter 7. In particular, the working teams did not find a sufficient reason for including in the catalogue of exceptional rules further privileges from liability for individual professional groups.

VI.–7:101. This Article picks up the rule in I.–1:102 (Interpretation and development) paragraph (2) for the purposes of this Book. Strictly speaking, this is perhaps unnecessary. However, the influence of fundamental rights on the law on private liability is particularly strong, which is why an express statement and a somewhat more definite formulation appeared helpful. Not only are the rules of this Book to be interpreted in the light of the respective applicable constitutional law, in fact their application falls under the general proviso that they are congruent with the constitutional protection of fundamental rights. This is not only a constitutional statement, but also one of the law on non-contractual liability. It becomes particularly clear in connection with the evaluation of infringements of personality rights by the press. Here, like everywhere else, it is a self-evident aspect of the present branch of the law that it seeks to protect fundamental rights (like freedom of press) and not infringe them.

VI.–7:102: Statutory provisions

National law determines what legal provisions are statutory provisions.

COMMENTS

The Articles of this Book use the expressions “statute” or “statutory provisions” on many occasions (see VI.–2:202 (Loss suffered by third persons as a result of another’s personal injury or death) paragraph (2)(c), VI.–3:102 (Negligence) sub-paragraph (a), VI.–3:206 (Accountability for damage caused by dangerous substances or emissions) paragraph (5)(b) and VI.–5:401 (Contractual exclusion or limitation of liability) paragraph (4)). In each case, statutes in a material sense are what is meant by “statutes”, not necessarily parliamentary statutes (see Comments under VI.–3:102 (Negligence)). Such norms, which are binding for all, take a diverse spectrum of outward forms. Their detailed classification and distinction from individual regulations on the one hand and sets of rules without normative character on the other (the usual of example of which would be the safety regulations of public insurance or maintenance bodies), cannot be provided by these model rules. Clarifying this is the aim of the present Article.

VI.–7:103: Public law functions and court proceedings

This Book does not govern the liability of a person or body arising from the exercise or omission to exercise public law functions or from performing duties during court proceedings.

COMMENTS

Relationship with I.–1:101(2). This Article absorbs the rule in I.–1:101 (Intended field of application) paragraph (2), concretising and extending it for the purposes of the law on non-contractual liability. This Book neither concerns itself with issues of liability for the erroneous exercise of sovereign power nor with questions of liability for damage in connection with

conducting court proceedings. The same applies to matters relating primarily to procedure or enforcement (I.–1:101(2)(h)).

Person or body exercising public law functions. Remaining excluded from the scope of application of this Book is the liability of the State and its institutions as well as the personal liability of its office holders for the exercise or the failure to exercise sovereign power in breach of duty.

Illustration

X, a prison inmate and perpetrator of violence, is let out on parole on many occasions and, after a period of time, even let out for one year. During this time, he abducts a woman and forces her to perform sexual acts. Neither the issue of whether the State is liable for the wrongful omission of its officials, nor the question of whether one of them is personally liable, is governed by these rules.

What exactly is to be understood under the exercise of public authority is to be decided in conformity with the criteria developed on EC Treaty art. 45(1). Remaining borderline cases must be left to the respective *lex fori* for demarcation; whether it is possible for uniform criteria on the demarcation between the realisation of public functions on the one hand and private law (fiscal) duties on the other, could not be verified.

Performing duties during court proceedings. Moreover, this Book contains no statement on the liability of judges or the liability of lawyers and expert witnesses for their activities in court. In this area of their professional activity, all three professional groups typically enjoy privileges from liability, which remain unaffected by the rules of this Book. The term “court” includes arbitration tribunals, see I.–1:103 (Definitions) paragraph (1) in conjunction with Annex I, keyword “Court”.

VI.–7:104: Liability of employees, employers, trade unions and employers’ associations

This Book does not govern the liability of:

- (a) employees (whether to co-employees, employers or third parties) arising in the course of employment;*
- (b) employers to employees arising in the course of employment; and*
- (c) trade unions and employers’ associations arising in the course of industrial dispute.*

COMMENTS

General. This Article is another example of the application of I.–1:101 (Intended field of application) paragraph (2). Issues on the border between the law on non-contractual liability and individual and collective labour law are removed from the scope of application of this Book. This is an area of great sensitivity in legal and social policy, to whose great complexity justice cannot be done by these model rules.

Individual labour law. Therefore, on the one hand, all issues remain excluded from these rules which relate to the personal liability of employees for damage caused by them in the course of their work. This applies to harming colleagues from the same establishment, as well as to damage to the detriment of the employer and of third parties, whether they are employees themselves or not (sub-paragraph (a)). The reason for remaining silent on the

liability between members of the same enterprise is to be primarily found in the circumstance that in many legal systems this problem area is subject to a specific regime of occupational accident insurance, which for its part demands priority of application over the general law on non-contractual liability. Issues on the relationship to third parties remain out of the equation because the field covering the personal liability of employees *vis à vis* external parties is (i) very controversial from a general policy perspective and because they (ii) are not capable of consistent development without considering the internal relationship between the employer and employee, which is subject to the rules of the law on labour contracts. Therefore, issues of joint and several liability shared between employer and employee also fall under this exclusionary rule in cases in which the personal liability of the employee for damage occasioned to third parties results from the applicable law. Sub-paragraph (b) follows the same philosophy for the reverse situation (claims of the employer against the employee). The qualification of the relevant legal issue as falling under either non-contractual liability law or labour law is not decisive here.

Collective labour law. Sub-paragraph (c) covers issues of non-contractual liability in connection with industrial disputes. Thus, it covers not only liability for the consequences of a strike, but also liability for counter-measures (including lock-outs) on the part of the employer in the context of disputes over working conditions and pay.

VI.-7:105: Reduction or exclusion of liability to indemnified persons

If a person is entitled from another source to reparation, whether in full or in part, for that person's damage, in particular from an insurer, fund or other body, national law determines whether or not by virtue of that entitlement liability under this Book is limited or excluded.

COMMENTS

Channelling of liability. This Book ultimately leaves untouched those rules of national law which displace the rules of civil liability in certain spheres by way of an insurance regime under which the injured person loses the claim to damages under the law on non-contractual liability and in its place receives a claim against an insurer, a fund or another institution. Thus, this does not involve situations in which a right to reparation passes to an insurer by operation of law. This is because in these cases the right remains preserved and it is solely a change of creditor which takes place. Cases of mere *de facto* channelling of liability to an insurer (by which it is open to the injured person to decide between a claim against the injuring person and a claim against the insurer) are also not in issue here. In fact, VI.-7:105 only pertains to the *de jure* channelling of liability by rules that relieve the injuring person of liability where and because the injured person is indemnified by a third party, in particular by an insurer.

Examples. To the extent that such rules relate to the law on occupational accidents, they are already covered by VI.-7:104 (Liability of employees, employers, trade unions and employers associations). However, they are in no way restricted to this branch of the law; in fact, they may also be encountered in other matters, for instance, liability in the health sector, liability for road accidents or quite simply where liability between private persons for negligent damage to property is excluded if and in so far as the owner is insured against the damage or destruction of the thing. It is also conceivable that rules might provide, for example, that a claim cannot be made against the keeper of a motor vehicle on the basis of strict liability and

that the victim must instead obtain redress from the keeper's insurer because it would be regarded as an abuse of law to go against the keeper directly and personally. VI.-7:105 also encompasses such rules as channel liability *de jure* to a legal entity, where for example the liability of teachers in a private school is channelled to the State.

BOOK VII

UNJUSTIFIED ENRICHMENT

CHAPTER 1: GENERAL

VII.–1:101: Basic rule

(1) A person who obtains an unjustified enrichment which is attributable to another's disadvantage is obliged to that other to reverse the enrichment.

(2) This rule applies only in accordance with the following provisions of this Book.

COMMENTS

A. General

Overview. Paragraph (1) provides for a non-contractual obligation. Its effect is that a person who has obtained an unjustified enrichment is obliged in certain circumstances to restore it or transfer it or pay its money equivalent to the person at whose disadvantage the enrichment was obtained. Paragraph (2) makes it clear that this basic rule must be read in conjunction with the following provisions of this Book. They determine the circumstances in which such an obligation arises, the meaning of “enrichment” and “disadvantage”, the measure of liability, the existence of any defences, and the relationship of this norm to other legal rules with the same or a similar effect.

A single general norm. Paragraph (1) sets out a rule of general application which provides the only foundation of a claim under this Book. In this regard the structure is comparable to that adopted in the Book on non-contractual liability for damage, where there is also a single basis for liability rather than a multitude of separate heads of liability for distinct torts or delicts.

Scope. Paragraph (1) gives effect to a basic norm which is comprehensive in nature, embracing all liabilities arising out of the autonomous law of unjustified enrichment. It is immaterial for these purposes whether the enrichment claim arises out of a performance under a failed contractual arrangement (in other words: where the parties have failed to conclude a valid and unimpeachable contract) or some wrongdoing such as taking or using without the consent of the entitled person. The basic rule applies both to enrichments conferred by the claimant and enrichments not conferred by (i.e. enrichments extracted from) the claimant. The basic norm is accordingly phrased in wide terms so as to encompass what in the present European legal systems is often addressed by several complementary discrete rules, sometimes encroaching on other areas of law.

Operation only in conjunction with the other provisions of the Book. Paragraph (1) of the Article is not free-standing. The application of the basic rule is fleshed out and qualified by later provisions. Paragraph (2) makes it clear that the basic rule cannot be applied in isolation from the other Chapters of the Book. The meaning of the basic rule is thus anchored by the later provisions and its manner of application can only be determined by a consideration of the ensuing Articles. These define or amplify the various elements invoked by the basic rule, such as “unjustified”, “enrichment”, “disadvantage”, and “attributable”. In so doing they render its application to specific cases more certain (a particularising function) and control its sphere of operation (a constraining function).

Elements of the basic rule. The basic norm sets out all the elements which must be present to support a claim in the law of unjustified enrichment, leaving their content to be determined in the subsequent Chapters. Thus in order for a claim to arise under this Book, the following conditions must be satisfied. First, there must be a “person” who is the debtor of the claim and an “other” who is the creditor of the enrichment claim (see B8-12 below). Second, the potential debtor of the claim must have ‘obtained’ some benefit (see C13-14 below). Third, the enrichment must be “unjustified”. Whether an enrichment is justified or unjustified is determined by the rules set out in Chapter 2 (When enrichment unjustified). Fourth, the benefit obtained by the potential debtor must amount to an “enrichment”. Fifth, the potential creditor of the claim must have sustained a “disadvantage”. These two matters are governed by the rules in Chapter 3 (Enrichment and disadvantage). Finally, the enrichment must be “attributable” to this disadvantage. This last aspect is addressed by the rules in Chapter 4 (Attribution).

Content of the obligation; defences. If all the elements of the basic rule are established and the matter is not affected by defences (as to which see Chapter 6 of this Book), the debtor in the enrichment claim is obliged, in favour of the creditor of the claim, “to reverse the enrichment”. The manner in which this liability to reverse the enrichment is to be discharged as well as the extent of that liability is governed by the provisions in Chapter 5 (Reversal of enrichment). Finally, Chapter 7 (Relation to other legal rules) contains (among others) provisions which restrict the scope of application of the basic rule.

How the basic rule works. In each case in which a liability under unjustified enrichment might be considered to arise it must be determined whether the elements of the basic norm are satisfied, whether there is a defence and, if that is not the case, what is the content of the liability. The following illustrations indicate how this functions in relation to typical groups of cases.

Illustration 1

By mistake a purchaser P makes a second bank transfer of the purchase price to V, the vendor, an employee of P’s having already effected a bank transfer of the purchase price the day before. V is enriched because he has obtained a right against his bank B to payment of the sum credited to his bank account (VII.–3:101 (Enrichment) paragraph (1)(a)). (That enrichment is justified in relation to B, but in relation to P it is not justified because V did not have any right against P to this (second mistaken) payment and P did not intend to make a gift to V. The matter turns on the (missing) ground of justification in relation to P (VII.–2:101 (Circumstances in which an enrichment is unjustified) paragraph (1)(a) and (b)). That V’s enrichment (in the form of the credit to his account) is justified in relation to V’s bank does not affect the matter. P has sustained a disadvantage because P’s bank has (correctly) deducted the

corresponding amount from P's account (VII.-3:102 (Disadvantage) paragraph (1)(a)). The enrichment of V is attributable to the disadvantage of P: P transferred part of its patrimony to V (VII.-4:101 (Instances of Attribution) paragraph (a)). Technically speaking, of course, P did not transfer its claim against its bank to V, but the precise technical arrangements for the bank transfer are not material here: from the economic and legal standpoint the banks in this case have only served as machinery for effecting a cashless method of payment which can be equated with a cash transfer. (Had P deposited cash at V's bank to the credit of V's account, the case would have come within VII.-4:101 (Instances of attribution) paragraph (d)) The subject-matter of V's enrichment is a transferable asset: bank account credits can be reversed by bank transfer. Consequently V is obliged to P to transfer back the second payment (VII.-5:101 (Transferable enrichment) paragraph (1)).

Illustration 2

A debtor D intends to pay a debt due to D's creditor C by means of an electronic funds transfer. By mistake D enters into the on-screen formula a false bank sorting code which results in the money being credited to the account of X, a person completely unknown to D: at the bank branch with the sort code which D entered by mistake X has an account with the same number as C's account number at C's bank. S has a claim against D to re-transfer of the money. This follows from the same reasoning as in Illustration

Illustration 3

A is constructing a housing estate for B on the latter's land. A commissions a sub-contractor C to supply and install all the electric cookers and hot water tanks for the houses. C performs his contract with A. However, as A has become insolvent in the meantime, C demands payment from B. Under the applicable property law, B has become owner of the appliances and has thus been enriched by acquiring property rights in them (VII.-3:101 (Enrichment) paragraph(1)(a) and (b)). C is disadvantaged correspondingly: (VII.-3:102 (Disadvantage) paragraph (1)(a) and (b)). The enrichment of B is not justified in relation to C under VII.-2:101 (Circumstances in which an enrichment is unjustified) paragraph (1)(a) because the acquisition of ownership by operation of law only creates a right of title (i.e. a right to retain the thing) and not a right to be able to retain the thing without having to make a compensatory payment. However, the enrichment of B is nonetheless justified in relation to C (and not just in relation to A: see VII.-2:101 (Circumstances in which an enrichment is unjustified) (1)(a)) under VII.-2:102 (Performance of obligation to third party). That C made a mistake as to the solvency of A when he rendered the contractual performance does not change the situation: a mistake of this type does not destroy the ground of justification (see VII.-2:103 (Consenting or performing freely)).

Illustration 4

Contrary to a prohibitory rule, X, who lacks the professional qualification required by statute for providing legal services, advises Y in a legal matter in return for payment. Y is enriched by being advised; X is correspondingly disadvantaged by rendering a service (VII.-3:101(1)(b) and 3:102(1)(b)). The enrichment of Y is unjustified (VII.-2:101 (Circumstances in which an enrichment is unjustified) paragraph (2)). It may be assumed that the contract between X and Y for the remunerated provision of legal advice is void (II.-7:302 (Contracts infringing mandatory rules)). Nor can a justification be found in the law on benevolent intervention in another's affairs (VII.-2:101 (Circumstances in which an enrichment is unjustified) paragraph (1)(a)). Y is

therefore seemingly obliged to pay to X the agreed price or, if this is less than the agreed price, the objective value of such unqualified legal advice (VII.–5:102 (Non-transferable enrichment)). However, the purpose of the prohibition of unqualified remunerated legal advice is the protection of those seeking legal advice, and the market for provision of legal advice, from persons who have omitted to satisfy the requirements of legal training. Consequently X has no claim at all to recompense (VII.–6:103 (Illegality)).

Illustration 5

E, who operates a radio station, publishes advertising material for its station featuring a prominent (manipulated) photograph of D, a Formula One Grand Prix world champion, listening to a portable radio on which the radio station's logo is clearly visible. The evident intent of the publication is to encourage the view that D is an avid listener to and an endorser of E's radio broadcasts. E is enriched by making use of an asset of D (VII.–3:101 (Enrichment) paragraph (1)(c)) – namely D's right of personality. As D would have a right to prevent E using a photo of himself for its commercial purposes without his consent (see VI.–1:102 (Prevention)), D would be entitled to permit commercial use of his image and reputation in this manner in return for a fee; such rights have the quality of an "asset". D is disadvantaged correspondingly (VII.–3:102 (Disadvantage) paragraph(1)(c)). The case is one of infringement by E, to E's commercial advantage, of D's rights (VII.–4:101 (Instances of attribution) paragraph (c)). E's enrichment is unjustified since D's disadvantage in suffering the use of his right of personality was sustained without his consent (VII.–2:101 (Circumstances in which an enrichment is unjustified) paragraph (1)(b)).

Illustration 6

In an advertisement X uses a photograph of a famous politician, Y, who has recently resigned a ministerial position after only a short time in office following a disagreement with the premier on policy. The image is in a series of fifteen other photographs which depict the members of the cabinet who are still in office. The picture of Y is crossed through. The accompanying slogan reads: "We also lease cars to staff on probation." Under the general rules on protection of rights of personality the claimant Y must accept that his image be used for the purposes of such satire. No right of Y has been infringed; Y has suffered no legally relevant damage (cf. VI.–2:203 (Infringement of dignity, liberty and privacy)). Consequently Y has suffered no disadvantage; there has been no use of a right of Y (cf. VII.–3:102 (Disadvantage) paragraph (1)(c)). Hence Y has no claim to recompense under the law of unjustified enrichment.

B. Parties: "a person"; "another"

General. The basic rule envisages two parties, one of whom has obtained an unjustified enrichment and the other of whom has sustained a disadvantage to which the enrichment is attributable. The effect of the rule is to bind those parties one to another in a relationship of legal obligation, the enriched party being obliged to reverse the enrichment and the disadvantaged party having a corresponding right to the reversal. The only necessary connection between them is the obligation to reverse the unjustified enrichment arising *ex post facto* from the circumstance that the one has obtained an enrichment without justification at the other's expense.

Absence of need for prior connection. It may be the case, but need not necessarily be so, that before the enrichment was obtained the parties were connected by a contractual or other

legal relationship. An enrichment claim may arise between persons who are connected to one another merely as a result of the transfer of benefit which has generated that claim.

Illustration 7

D, a bank, is instructed by its customer X to make a payment to the credit of E's account at another bank. D carries out the bank transfer, but as a result of its own mistake D subsequently repeats the transfer payment so that E is paid a second time. D has a claim against E under this Book for the reversal of E's enrichment arising out of the second (mistaken) transfer. It is immaterial that there was no pre-existing legal relationship between E and D.

Absence of need for direct transfer. Equally it is immaterial whether the unjustified enrichment was directly conferred by the creditor of the enrichment claim on the debtor (or directly extracted by the latter from the former) or whether instead the enrichment is mediated through a third party (as where an act of a third party results in a transfer of ownership from claimant to enriched person) or the result of a chain of transactions where the claimant's enrichment of a third party by is linked to that third party's enrichment of the ultimately enriched person. Third party situations are further explained in the Comments to VII.–2:102 (Performance of obligation to third person).

Illustration 8

D is entitled to the estate of a deceased person, which includes a claim against X, a debtor of the deceased. Nonetheless E succeeds in obtaining a certificate of inheritance for that estate and on the strength of the certificate collects payment of the debt from X. Because of the special effect of a certificate of inheritance, X is regarded as a matter of law as having discharged the debt to the deceased's successor, even though E was not entitled to the debt. E is enriched by obtaining the payment from X (VII.–3:101 (Enrichment) paragraph (1)(a)). D is disadvantaged by losing the right to performance from X, which D has inherited from the deceased creditor (VII.–3:102 (Disadvantage) paragraph (1)(a)). E's enrichment is attributable to D's disadvantage under VII.–4:103 (Debtor's performance to a non-creditor; onward transfer in good faith) because X's payment to E extinguished D's right to performance. The enrichment is unjustified under VII.–2:101 (Circumstances in which an enrichment is unjustified) paragraph (1) because E had no entitlement to the payment in relation to D (only in relation to X, by virtue of the certificate of inheritance) and D did not consent to the loss of the claim against X.

Illustration 9

Following a divorce, A makes a holograph change to his will to benefit C in place of B, his ex-wife. Under the applicable law the automatic consequence of this change is that B also loses the right to the proceeds of A's own life insurance with the insurer X; that right passes to C. X, however, is not informed of the change in the will and therefore pays the lump sum under the life insurance to B; the payment discharges X's liability under the life insurance contract. C has a claim against B on the basis of unjustified enrichment. The reasoning is the same as in Illustration

Natural persons and legal persons. Precisely because the terms are not qualified in the basic rule, the disadvantaged claimant (“another”, i.e. another person) and the enriched party (“a person”) may be either natural or legal persons. The same holds for other parties referred to in the subsequent provisions, be it a “third person”, “representative” or “intervener”.

Persons without full legal capacity. Equally, the terms enriched or disadvantaged “person” (and correspondingly “third person”, “representative” and “intervener”) are not in any way restricted to persons having full legal capacity. Model cases for the possible application of the law of unjustified enrichment will involve enrichments conferred by or on under age persons. By reason of their minority, they lack full contractual capacity and therefore may easily come to enrich another or be enriched by another in the absence of a binding legal obligation justifying the enrichment. The same is true for the reversal of transfers by legal persons acting beyond the powers contained in their founding instrument (such as a gift for purposes or in circumstances not contemplated by that instrument).

C. Mode of enrichment: “obtains”

Application to both active and passive enrichment. The term “obtains” is intended to have a neutral meaning and to denote merely that the relevant benefit has reached the patrimony or person of the potential debtor in the enrichment claim. It therefore includes cases of wilful appropriation, but does not necessarily imply any positive act of acquisition. Passive receipt, absorption, or enjoyment of an enrichment is equally an ‘obtaining’ for the purposes of the article. Thus the enrichment may be conferred by the claimant or a third party entirely without the enriched person’s knowledge (e.g. where funds are transferred to another’s bank account by mistake or goods are deposited on another’s publicly accessible premises). However, if the other elements of the enrichment claim are established, the manner in which the enrichment is obtained – and in particular whether or not the enriched person consented to their enrichment – could be material in determining the extent of the enriched party’s liability. That is because if the enrichment cannot be reversed by a transfer, an innocent enriched person who would otherwise be compelled to pay for an enrichment which they never requested is worthy of protection. This aspect is addressed in VII.–5:102 (Non-transferable enrichment).

No requirement of wrongful enrichment. Equally it is immaterial for these purposes whether the enrichment is wrongful or not – whether it is the result of the enriched person’s own wrongful act or the wrongful intervention of a third party who has passed the benefit to the enriched person. The term “obtains” is not qualified and therefore as a matter of principle no distinction is drawn as to the lawfulness of the mode of acquisition. Whether the acquisition was wrongful plays a role, however, in so far as it may be material to other elements of the enrichment claim – in particular in determining whether, as between the parties, the enrichment is justified or not, whether the enrichment is attributable to the disadvantage, and whether the enriched person has a defence. See further VII.–2:103 (Consenting or performing freely), VII.–4:101 (Instances of attribution) paragraph (c), VII.–4:105 (Attribution resulting from an act of an intervener) and VII.–6:103 (Illegality).

D. Content of liability: “obliged to reverse the enrichment”

Transferable and non-transferable enrichments. The basic rule creates an obligation to reverse the enrichment. As already indicated (see A6), the manner in which and the extent to which an enrichment is to be reversed is determined by subsequent provisions. The starting proposition is that enrichments which are transferable (e.g. things) are to be restored in natura, while non-transferable enrichments are to be reversed by paying their objective value. In relation to used items, both aspects may apply in relation to one and the same thing.

Illustration 10

A is supplied by B with a motor vehicle. Due to a latent disagreement, no valid contract of sale has been concluded. B has a claim against A for a return of what A has

received by virtue of the supply of the car, i.e., depending on the applicable law of property and in particular transfer of title, possession of the vehicle or possession and ownership of the vehicle (VII.–5:101 (Transferable enrichment) paragraph (1)) and, moreover, recompense for use of the car. The obligation to pay in respect of the latter arises from VII.–5:102 (Non-transferable enrichment) if A has not acquired ownership of the vehicle. If, on the other hand, A was also owner during the period of possession of the vehicle, she is only liable to pay in respect of the benefit of using what became her own vehicle if she was in bad faith or if she has made a saving (VII.–5:104 (Fruits and use of an enrichment)).

Personal and proprietary claims. The basic rule confers on the disadvantaged person a personal right to reversal of the enrichment. Whether the enrichment claim ought to have a quasi-proprietary effect, whereby the claimant obtains priority over the enriched party's other creditors in the event of bankruptcy, for example, is not determined in this Book. The matter is left open: see VII.–7:101 (Other private law rights to recover) paragraph (2). A disadvantaged person who has retained ownership of the asset whose possession constitutes the other's enrichment may be able to proceed against the enriched person to recover possession on the basis of proprietary rights. That possibility is left open in VII.–7:101 (Other private law rights to recover) paragraph (3) this Book does not limit those rights to vindicate property in any way.

CHAPTER 2: WHEN ENRICHMENT UNJUSTIFIED

VII.–2:101: Circumstances in which an enrichment is unjustified

(1) An enrichment is unjustified unless:

- (a) the enriched person is entitled as against the disadvantaged person to the enrichment by virtue of a contract or other juridical act, a court order or a rule of law; or*
- (b) the disadvantaged person consented freely and without error to the disadvantage.*

(2) If the contract or other juridical act, court order or rule of law referred to in paragraph (1)(a) is void or avoided or otherwise rendered ineffective retrospectively, the enriched person is not entitled to the enrichment on that basis.

(3) However, the enriched person is to be regarded as entitled to an enrichment by virtue of a rule of law only if the policy of that rule is that the enriched person is to retain the value of the enrichment.

(4) An enrichment is also unjustified if:

- (a) the disadvantaged person conferred it:*
 - (i) for a purpose which is not achieved; or*
 - (ii) with an expectation which is not realised;*
- (b) the enriched person knew of, or could reasonably be expected to know of, the purpose or expectation; and*
- (c) the enriched person accepted or could reasonably be assumed to have accepted that the enrichment must be reversed in such circumstances.*

COMMENTS

A. Enrichments unjustified for want of legal basis or consent: para. (1)

Overview. This Article provides that an enrichment is unjustified unless one of two conditions is satisfied. An enrichment is justified if it is a benefit to which the enriched person was entitled (*vis-à-vis* the disadvantaged person) under a juridical act (such as a contract), a court order or a rule of law. Alternatively an enrichment is justified if the disadvantaged person has consented to the disadvantage, provided that consent is free and not based on error. VII.–2:103 (Consenting or performing freely) sets out the circumstances in which a disadvantaged person’s consent is to be regarded as not having been given freely – namely, where it is affected by incapacity, fraud, threats or unfair exploitation.

Absence of legal basis, not unjust factors. This Article takes as a starting point the notion that an enrichment is unjustified unless one of two broad exceptions applies. By virtue of this provision any enrichment which is not supported either by some legal basis, such as a contractual right against the disadvantaged person, or by the disadvantaged person’s consent is regarded as unjustified. In other words, an enrichment is unjustified unless it is justified by a contract (or other juridical act) with the disadvantaged person or a court order or rule of law or the disadvantaged person’s consent. There is therefore no catalogue of particular matters which trigger an absence of justification (‘unjust factors’); such an approach takes the converse starting point that an enrichment is justified and looks to identify a reason for treating it otherwise.

Two alternative justifications. In order to constitute an “unjustified” enrichment both the exceptions in paragraphs (1)(a) and (1)(b) must be negated. Thus, despite the broad wording of paragraph (1)(a), an enrichment for which there is no legal basis will only be unjustified if the disadvantaged person did not confer the enrichment voluntarily or, if it was conferred voluntarily, this was induced by some mistake (e.g. as to the existence of a binding obligation to do so), fraud, threats, or the like vitiating factor. This ensures that a person who is *sui juris*, and who has conferred the enrichment in full awareness of the situation and free of imposition has no claim under this Book.

Effect of paragraph (2). Paragraph (1)(a) indicates the legal bases which justify an enrichment: (i) contract or other juridical act; (ii) court order; or (iii) rule of law. Para. (2) qualifies this notion of a legal basis. It makes it clear that there is a legal basis only if the juridical act, court order, or rule of law is valid. A juridical act, court order or rule of law which is void from the outset, or voidable and avoided, or in some other manner rendered ineffective retrospectively, does not establish a legal basis. Indeed it is precisely for cases such as these, where the contract is void and one or both of the parties perform their apparent obligations arising out of that contract, that the law of unjustified enrichment is intended to be applicable.

Effect of paragraph (3). An entitlement to an enrichment by virtue of a rule of law only constitutes a justification for the enrichment if that entitlement is more than merely formal – i.e. it is the policy of the law that the enriched person should have the benefit of and not merely the title to the enrichment. See further Comments..

Relationship to paragraph (4). Paragraph (4) expands the notion of what is meant by “unjustified” beyond those enrichments brought within the definition by paragraph (1). Paragraph (4) provides that if its requirements are met, an enrichment is also unjustified if it is conferred for a purpose which is not achieved or with an expectation which is not realised. Such enrichments are of course unjustified under paragraph (1) in any case if there was no legal basis for the enrichment. Paragraph (4) extends the notion of “unjustified” by including enrichments conferred for a failed purpose or a disappointed expectation even where there is a legal basis for the enrichment. If the restrictive conditions of paragraph (4) are satisfied, such enrichments are unjustified notwithstanding that they were provided by the disadvantaged person in performance of a contractual obligation owed to the enriched person.

Relationship to VII.–2:102 (Performance of obligation to third person). VII.–2:102 (Performance of obligation to third person) provides that enrichments conferred in or arising from the performance of an obligation owed to a third person are as a rule justified. This has the consequence that generally any claim under the law of unjustified enrichment will be against the other party to the (void) obligation. A claim against the actual recipient will as a rule fail. The disadvantaged person must instead direct the enrichment claim against the contractual partner.

Prestations by both parties. Where both parties to a contract which is of no effect have performed their apparent obligations under it, both prestations will be unjustified and accordingly both of the parties will ordinarily have individual claims to a reversal of the unjustified enrichment which their respective performance under the contract brought about. In such a case, of course, possibilities for set-off may arise, depending on the nature of the claims. Where a service is provided or assets are used in exchange for a payment, reversal of the enrichment in receiving the service can necessarily only involve a money payment because the enrichment is of its nature not transferable (see VII.–5:102 (Non-transferable enrichment)), so that the possibility of set-off exists. This assumes that the liability in respect of the non-transferable enrichment is something other than the price paid, which in view of paragraph (3) of that later Article (establishing a minimum liability of the agreed price if the contract genuinely fixed the price for the enrichment) will not always be the case. If the contract is a genuine agreement (though void for technical reasons) and fully performed, and the enrichment on both sides is either money or non-transferable, the parties may ultimately be unaffected by enrichment law.

B. Justification under a contract or other juridical act

(a) General

Entitlement under a juridical act. Subject to the possible application of paragraph (4) (as to which, see A0 above), an enrichment is justified (under paragraph (1)(a)) if the enriched person is entitled to it as against the disadvantaged person by virtue of a juridical act.

Juridical act. Juridical acts of relevance here are those which grant or oblige a party to provide some benefit or confer on the other party (or a third party) a right to that benefit. Besides contracts, this includes acts of assignment and the creation of trusts and testamentary dispositions. However, by far and away the most important type of juridical act in this context is a contract and the following comments clarify the operation of this rule primarily against that background.

(b) In particular: entitlement under a contract

General. If the parties have concluded a valid contract for the provision of goods or services, the contents of that contract will govern the recipient's liability in respect of the supply. The enrichment is justified by virtue of the contract and no question of liability under this Book arises. It is therefore not possible for a party to a valid contract to escape a bad bargain by contending that the other party is liable (e.g. to return the goods or to pay the higher market price for them) under enrichment law.

Valid concluded contract without a specific determination of the price. This principle applies even where the parties have not specifically determined the price of the goods or services to be supplied. Provided that the parties have reached a sufficient agreement so as to have concluded a valid contract, the recipient's liability will be governed by contract law which fills the gap left by the parties. Where the parties fail to agree a specific price, the rules of contract law imply an obligation to pay a reasonable price: II-9:104 (Determination of price). Enrichment law will apply only where there is no valid contract. This may be the case because the parties still intend to agree a specific price between themselves. Indeed, more generally, the absence of an agreement on price may be a sign that the parties are still negotiating. Thus the borderline between contract and enrichment law is between a concluded contract on the one hand and, on the other hand, an absence of agreement or an incomplete agreement falling short of a valid contract. If the contract is valid, it is immaterial whether its contents have been expressly agreed or must be filled out by resort to legal rules or implied terms.

Illustration 1

E commissions D, a joiner, to undertake work on repairing an attic. It is agreed that the work should be completed within an extremely tight time frame. Although it is understood that the professional work will be remunerated, nothing is explicitly agreed about the price. D completes the work. D has a claim in contract law, and not under this Book, for a reasonable price for the work done. Since the parties intended to be legally bound and that E would pay D for the work, D and E concluded a valid contract. Where the parties fail to agree a specific price, the rules of contract law imply an obligation to pay a reasonable price: II-9:104 (Determination of price). The reasonable price for the work takes account of the terms under which the service was provided – i.e. the “added value” which D provided by completing the job within a narrow time frame.

Partial invalidity. Where an enrichment is obtained as a result of a contractual right and that right is effective only in part, the enrichment will be justified under this Article only in so far as the right is valid and it will be unjustified in accordance with this Article to the extent of the invalidity. Hence goods or services supplied under a partially void or avoided contract will be a justified enrichment so far as supported by the valid part of the contract and otherwise unjustified.

Illustration 2

The lease between L and T contains a provision apparently conferring on the landlord L the right to increase the rent due from the tenant T. L makes use of this apparent right on several occasions and T pays the increased rent. Under the law governing the lease the rent adjustment clause is void. Since the validity of the contract is otherwise unaffected, the enrichment of L is justified as regards the sums which were due as rent

under the original terms of the lease, but is not justified as regards the additional sums paid over and above that on the basis of the supposed rent increase.

Illustration 3

D obtains a loan from E of €20,000. €35,000, representing principal, interest and a penalty for early re-payment, is repaid. D subsequently succeeds in obtaining a court order determining that interest and the penalty for early re-payment together constituted an extortion and reduces the sum due under the contract to €28,000. To this extent D's repayment to E is justified. E's enrichment is not justified to the extent of the residual €7,000 which was paid in respect of a contractual right which retrospectively was without effect.

Entitlements not specifically enforceable. Provided there is a valid juridical act, it is immaterial whether the obligation to provide the enrichment which arises under the juridical act (or the corresponding right to have the enrichment conferred) is specifically enforceable in the particular circumstances of the case.

Unenforceable entitlements. The same applies even where the entitlement, though legally recognised and valid, is not capable of producing legal sanctions in the event of a default – in other words, there is not even a right to compensation for non-performance. An entitlement which is entirely unenforceable – that is to say, a right to the enrichment which the creditor cannot enforce because the debtor is entitled to refuse performance – is nonetheless an entitlement within the sense of this article if in the eyes of the law the right arising from the juridical act is legal in nature and more than a merely moral claim. A material distinction is thus between cases where the debtor's obligation under the juridical act has determined or expired before performance (in which case there is no entitlement at the time of performance) and cases where the creditor is merely precluded from suing for performance (in which case there is a subsisting entitlement at the time of performance).

Performance not yet due. An enrichment conferred by a premature performance of an obligation under a contract – that is to say, a tender of performance of the debtor's contractual obligation before performance is actually due – may nonetheless be an enrichment to which the enriched person is entitled by virtue of the contract. This will be the case where the creditor actively accepts early performance or is not entitled to refuse it. That the creditor could not compel performance until performance became due is immaterial since paragraph (1) justifies enrichments obtained as a result of the performance of obligations which are not enforceable. Any enrichment which accrues to the creditor from the fact that performance is undertaken before it was due is in principle justified under this Book. Of course the juridical act itself may make provision for the legal consequences of early performance.

Illustration 4

Company D employs E as its agent to acquire nuts and bolts of various types for use in D's manufacturing business. Under the terms of their agreement D is to place E in funds necessary to make the required acquisitions by the 16th of each calendar month. Following a change in its banking arrangements, D transfers the necessary funds on the 1st, rather than the 15th of each month, as it had previously invariably done. Transfer of the funds was not due until the 15th. However, as acceptance of funds before they are due will not prejudice E's interests, E must accept D's performance before it is due (III.–2:103 (Early performance)). Premature payment was therefore a performance of D's obligation to place E in funds by the 15th. The benefit which

flows to E from early payment (such as any interest accruing on the deposit in the period between receipt and onward transmission) is an enrichment resulting from D's (premature, but accepted) discharge of an obligation under the juridical act. The enrichment is justified as against D by virtue of the contract between them. There is no liability under this Book. Any obligation of E to account to D for interest will depend on an express or implied term of the agreement between them imposing on E an obligation to account for the benefit of funds paid in advance and will be contractual. A right to recover under contractual rules is unaffected by this Book: see VII.-7:101 (Other private law rights to recover).

Obligation to suffer another's enjoyment. No distinction is drawn between enrichments resulting from an active performance and those resulting from the discharge of obligations to remain passive. In both cases the creditor has an entitlement to the benefit of the enrichment: whether the enrichment is to be conferred by the debtor or taken by the creditor (the debtor being obliged to suffer the creditor's interference) is immaterial.

Illustration 5

D contracts to rent vacant land to E. E takes possession of the land in accordance with the terms of their agreement. E's enrichment in using the land is justified because E is entitled to it under the contract.

Illustration 6

D pawns jewels with E, a pawnbroker. E is entitled under the terms of the pledge to retain the jewels until the money borrowed by D is repaid with interest and to sell them in the event that D fails to discharge her debt of repayment by an agreed redemption date out of the proceeds of sale. Retention and disposal of the jewels (and retention of the relevant amount of the proceeds of sale) in accordance with the terms of the pledge are enrichments to which E is entitled under the contract of pledge.

Performance as condition of another's liability. Entitlement by virtue of a contract extends to the case where a person is admittedly not obliged to render a performance, but does so in order to render another liable to confer some benefit. This situation arises, for example, where a contract binds one party only when the other does some act or omits to do some act but does not oblige the other party to do or not to do the act (a so-called unilateral contract). The significant aspect of the transaction for present purposes is that the promisee is not bound to fulfil the condition of the promise, although doing so will thereby render the promise unconditionally binding: the performance rendered by the promisee remains one which the promisee was never bound to undertake. At the same time, the behaviour of the promisee, which the other party's promise has induced, may well enrich the promisor – for example, it may amount to the rendering of a service. Such enrichments are nonetheless to be regarded as coming within the notion of enrichments to which the promisor is entitled by virtue of a contract, even though the person performing was not bound to do so.

Illustration 7

E hangs up in a local supermarket a poster on which E offers a specified reward to anyone finding and returning a dog of hers which has strayed. D sees the poster. He subsequently finds the dog and returns it to E. E has obtained a justified enrichment. However, D has a contractual claim against E based on the offer of the reward accepted by actings. (If the case is analysed as a unilateral binding promise rather than

a contract the result is the same because of the reference in the Article to “other juridical act”).

Illustration 8

E, a home owner, negotiates with D, an estate agent, with a view to D’s assistance in finding a buyer for E’s home. It is agreed between the parties that D is not bound to make any effort to find a buyer, but if D should do so E is to pay a commission based on a specified percentage of the purchase price. D subsequently advertises the property and is contacted by an interested purchaser to whom E’s property is sold as a result. E’s enrichment in the form of the service rendered by D is justified. D’s claim against E is contractual, based on the terms of the agreement between them.

Rationale. For the purposes of enrichment law at least, the case is functionally one of or comparable to performance of a contractual obligation and ought to be assimilated to any (other) performances under a contract. The policy of confining the parties to a valid contract to the rewards (and risks) envisaged by the terms of the contractual agreement applies to such a promise as much as to a typical bilateral contract. If the promisee has been prompted to act by the promise of reward held out to it by the other party and rendered binding by the promisee undertaking the required condition, it is unnecessary - and would be improper – to superimpose an entitlement to recompense under the law of unjustified enrichment. The promisee’s redress must be the enforcement of the promise. A promisee who has misjudged the arduousness of the task to be rendered or the meagreness of the reward offered ought not to be entitled to more (for example, the actual value of the service provided). The same holds where the promisee commences to fulfil, but fails fully to fulfil, the condition set out in the promise: the promisee ought to bear the risk of failure in view of the promisee’s free decision to gamble the promise of reward against the burden of discharging the condition of the promise. In such cases the principles which apply to incomplete performance of an entire contractual obligation ought correspondingly to apply to the incomplete venture to render a unilateral promise binding.

Illustration 9

E, a manufacturer of drinks and confectionery, advertises a competition for advertising slogans for its latest product, Slosh. A prize of €1,000 is offered to the winning entrant composing the most innovative slogan. It is a term of the offer that competitors agree to E using their slogans in publicity for the product. D, the winning competitor, produces a slogan which is used by E worldwide in its marketing for Slosh with recognised success. D cannot claim more than the contractually agreed €1,000 even though D has rendered a service to E worth considerably more than €1,000. Notwithstanding that D was not obliged to produce a slogan, E’s enrichment is one to which E was entitled by virtue of the contract concluded between them.

(c) Scope of the entitlement

Justification as to part of enrichment only. Where the enrichment conferred is above and beyond that which was dictated by the terms of the juridical act, the entitlement under the juridical act extends only to part of the enrichment. Accordingly the enrichment is justified only as to part, the excess being unjustified and a liability to reverse the enrichment may arise unless the matter is regulated by contract.

Illustration 10

D is contractually obliged to E to pay €500 and arranges for a bank payment to discharge this debt. As a result of a mistake for which D alone is responsible, D instructs her bank to transfer €5,000 to E's bank account. As D was obliged to pay to B €500, the enrichment is justified to this extent. The balance of €4,500 is unjustified under this Article.

Incomplete performance. Conversely, a person does not cease to be entitled to an enrichment merely because the enriched person is entitled to much more. A case in point is the incomplete performance by one party of an obligation. Where the enrichment results from a tender of performance which, so far as it goes, conforms to the contract, it will be covered by the entitlement and a justified enrichment, even though a completion of the performance is outstanding. It does not matter whether the obligation is discharged pro tanto or is an entire and indivisible obligation, discharged only when the performance is complete. The latter case is where one party fails to completely discharge the obligations, but has nonetheless enriched the other party to the contract by the partial performance, the non-performance of the outstanding remainder is not excused and the right to a counter-performance is contingent on a complete discharge of the obligations under the contract. If there is no termination of the contract by the enriched party in view of the other party's non-performance (as to which, see B0), the enrichment conferred does not give rise to an obligation to give recompense. This will rarely be unjust because (i) the usual remedy for the disadvantaged party will be simply to complete the work and claim the agreed reward for the complete performance of the contractual obligation and (iii) in cases where further performance is no longer possible and the risk of frustration was not the disadvantaged person's, obligations under the contract are automatically extinguished under II.-3:104 (Excuse due to an impediment) paragraph (4) (applicable where the impediment is "permanent"), and in that case the disadvantaged person is entitled to a reversal of the benefit conferred under the rules in III.-3:511 (Entitlement to assign) to III.-3:515 (Rights transferred to assignee).

Illustration 11

D, a building firm, contracts with E, a property developer, to construct a luxury block of flats for a fixed price payable on completion. After excavation work on the land and constructing the foundations, D realises that it has seriously underestimated its costs and that the contract is no longer economic for it. As E refuses to renegotiate the contract, D stops building. Although this work has not discharged the obligation to construct the building, it was nonetheless something to which E was entitled under the contract. Accordingly E has obtained a justified enrichment.

Illustration 12

E, the owner of a mansion, commissions D, an internationally renowned artist, to paint a mural on one of the internal walls of the building. It is a term of the contract that the wall will be painted by no one other than D (see III.-2:107 (Performance by a third person) paragraph (1)) and that the agreed remuneration will be paid only when the painting is complete according to the agreed design. After starting work but before completion, D dies as a result of self-induced intoxication. As the impediment to completion is the result of D's own misadventure and not due to matters outside D's control, the failure to finish painting is not excused (see III.-3:104 (Excuse due to impediment) paragraph (1) (Excuse due to an impediment)). D's successors have no claim under the law of unjustified enrichment for a payment of the value of the incomplete painting since D conferred the enrichment on E under a valid contract and the enrichment is accordingly justified.

Role of good faith in extreme cases. There may be extreme cases in which the benefit conferred is very substantial and the outstanding performance disproportionately small. If in such circumstances it is unjust for one party to take the benefit and rely on the fact that counter-performance is not due (because there has not been complete performance), there could be a breach of the party's duty to act in accordance with good faith and fair dealing (III.-1:103 (Good faith and fair dealing)) if the enriched party insists on the absence of a contractual obligation to provide recompense for the partial performance received. There may be said to be a failure to do what good faith and fair dealing requires in the extreme circumstances of the case in the enriched party's refusal to renegotiate the terms of the contract. In this way contract law caters adequately for any extreme case.

Deviations from contractual terms. Since justification of the enrichment depends upon an entitlement under the contract, an enrichment is as a rule unjustified if it falls outside the scope of the entitlement. Hence, for example, where a contractual performance tendered is outside the four corners of the contract (e.g. because the party tendering has made a fundamental mistake as to what was required) so that what the enriched person has received is not what was due, this Article regards the enrichment as unjustified. However, where in such a case the rules governing the juridical act regulate or oust a claim to restitution – and this is particularly the case where one party's performance of contractual obligations is not tangential and is merely sub-standard, where the exclusion of a right to restitution may be implicit in the fact that a party is confined to other remedies (e.g. repair) – those rules take priority. See paragraph (3) of VII.-7:101 (Other private law rights to recover).

(d) Validity of the juridical act

General. A legal basis for an enrichment - an entitlement to the enrichment based on a juridical act – depends on the validity of the juridical act. Only if the juridical act is valid is it capable by itself of supporting an entitlement to an enrichment and providing a ground of legal justification for the enrichment. A requirement that the juridical act be valid is not expressly spelled out in the wording of paragraph (1)(a). The principle is indicated by pointing out the opposite: that there is no entitlement and no justification for the enrichment where the contract is void or avoided or is otherwise rendered ineffective with retrospective effect: see paragraph (2).

Valid contracts. The existence of the valid contract provides a justification for the enrichments which arise out of it. Hence, where an enrichment is conferred by one party on another as a result of the due performance of an unimpeachable valid contract, there can be no claim under the law of unjustified enrichment (for a return of the benefit conferred or payment of its value).

Rationale. Since this rule excludes an “absence of justification” and so denies an essential element of the enrichment claim, the rule has the effect (from a functional point of view) of excluding the application of the law of unjustified enrichment to the consequences of a proper performance of a valid contract. This is compelled by the policy consideration that parties to a legally binding agreement should be confined to the contractually agreed rewards for their performances. The point is of significance where a party has sold for too little and the agreed reward is less than the real market value of a performance: parties in such a case should not be entitled to escape a (legally binding) bargain to pursue a more lucrative claim under the law of unjustified enrichment.

Illustration 13

D concludes a contract with E for the sale of 1,000 tonnes of thermal coal at an agreed price of \$75 per tonne. At the time stipulated for delivery to E, the prevailing market price of thermal coal has risen to \$98 per tonne. As a result, E will make an economic gain under this transaction of \$23,000 and D will make a corresponding economic loss. D delivers the coal. D has a contractual claim for payment of the agreed price. However, although E has made a gain at D's expense, D has no claim under the law of unjustified enrichment (either for return of the coal or payment of its current market value). E's acquisition of the coal is an enrichment to which E is entitled from D under the contract of sale.

In particular: matters not affecting the validity of the contract. In particular, if the enriched person is entitled to the enrichment under a contract which is valid (or voidable, but not avoided), the existence of matters such as a mistake, fraud, threat, or the like, are irrelevant. Such matters are relevant within the terms of the law governing the juridical act (i.e. contract law) in determining whether or not the contract or other juridical act is valid and accordingly whether the enrichment is justified. A mistake or fraud inducing a contract, for example, will not establish a right under this Book to a reversal of an enrichment conferred in performance of that contract if the mistake or fraud is not sufficient to establish a right to avoid the contract or if the right to avoid is not exercised. If, despite some factor undermining the consent of one or more of the parties to it, the contract remains valid, the enrichment will be justified, subject to paragraph (4), and there will be no liability under this Book.

Illustration 14

D, a property developing company, concludes a contract with E, an owner of vacant land, to purchase a large greenfield site for the development of luxury housing. From reports in the local press E, but not D, is aware that in future years there may be a risk of increased noise pollution at this site as permission has been granted for expanded use of a nearby airfield. Quite how dramatic that risk would be is, however, difficult to assess. The purchase price is within the range of possible prices a vendor might reasonably hope for from a purchaser with knowledge of this imprecise risk. Since E was not aware and could not reasonably be expected to have been aware that D lacked this public knowledge, the contract is not voidable (II.-7:201 (Mistake) paragraph (2)). D cannot demand a repayment of all or any of the purchase price paid to E on the ground that it would not have entered into the contract or not have entered into it at that price if it had been told of the airfield's permission. The enrichment is justified.

Illustration 15

Shortly before his niece's wedding, D promises to make a donation of €20,000 to his niece, E, as a wedding present. After fulfilling his promise, D discovers that the man his niece has married is a wealthy property tycoon. Had he known of the bridegroom's affluence at the time, D would not have made a gift of the money. It is supposed, for present purposes, that the binding nature of D's promise of a donation was not vitiated by D's mistaken assumption as to the financial position of E's future husband: the risk of such a mistake was assumed by D since he failed to inquire as to the financial position of the future bride and groom before making his promise: cf. II.-7:201 (Mistake) paragraph (2). As D is not entitled to avoid the promise to make a gift, the payment is justified as E had an entitlement to it by virtue of a juridical act. This is unaffected by the fact that E obtained the money from D because D parted with it

while labouring under a mistake. The mistake did not affect the validity of the promise.

In particular: donations. Where an enrichment is conferred by one party on another as an unimpeachable donation, the enrichment is justified and there is no possibility of a claim under the law of unjustified enrichment (whether for a return of the benefit conferred or payment of its value). Just as enrichment law cannot be used by one party to defeat a valid onerous contract which that party regards as a bad bargain, so the law of unjustified enrichment cannot be invoked to unwind a valid but regretted donation.

Illustration 16

D makes a gift to E of a large shareholding in a family company. D is subsequently disappointed by E's lack of business enterprise and regrets the gift, but cannot avoid the donation on grounds of mistake or on grounds of changed circumstances. D has no right under this Book to demand a reversal of E's enrichment. E has obtained the enrichment under a gift from D and accordingly it is justified by virtue of E's entitlement as against D under that juridical act.

Illustration 17

In order to avoid anticipated inheritance taxation, D, an elderly person, decides to make a gift of certain investments to his son, X, and his son's wife, E, jointly instead of leaving the property to them in his will. After D has made the gift, the relationship between X and E deteriorates and later ends in divorce. As part of the divorce settlement between the parties, X retains a one-third, E a two-third share in the investments. D regrets the gift, in view of the changed circumstances, so far as it relates to E's benefit. Nonetheless, the risk of such an outcome was assumed by D and thus D cannot revoke the donation. D has no claim under this Book against E if the continuance of the marriage between the donees was not a condition of the gift.

Voidable contracts not avoided. A contract which might be avoided, but which has not been, continues to have full effect, entitles each party to the performance due from the other party and provides a legal justification for the enrichments so conferred – notwithstanding that the contract might have been avoided. (This follows by implication *e contrario* from paragraph (2), which indicates that a person is not entitled if the juridical act is avoided.) Thus an enrichment obtained as a result of the other party's performance of obligations under a contract which is voidable but which is not in fact avoided is justified. This might be the case, for example, where a right to avoid the contract is lost by affirming it under II.–7:211 (Confirmation). Such contracts fall to be treated like any other contract which remains valid and fully operative. The contract remains valid for all purposes and the fact that a party may have other contractual remedies to obtain redress for being induced to conclude the contract, such as a right to damages under II.–7:214 (Damages for loss), is irrelevant here. The crucial fact is that the contract is not impeached and continues to subsist.

Rights to withhold performance. As indicated above (see B0), a juridical act supports an entitlement to an enrichment even though the performing party had (but did not exercise) a right to withhold performance. As in the case of a right to avoid a contract, the fact that a person bound by an obligation had a right to withhold performance will not render unjustified an enrichment which the person confers pursuant to a juridical act; the existence of the right (which one party fails to exercise) does not deprive the other party of the entitlement under the contract.

Illustration 18

D, an owner of shares, agrees to sell them to E. It is a term of the contract that transfer and payment are to be simultaneous. E fails to pay the purchase price on the agreed day, but assures D that he will pay soon. Notwithstanding that D has a right to withhold performance (under III.–3:401 (Right to withhold performance of reciprocal obligation)), D transfers the shares to E. D has no right to reclaim the shares under this Book. D's enrichment of E is justified: E's entitlement under the (valid) contract of sale to a transfer of the shares did not cease to exist merely because D had a right to withhold performance. Any right to a return of the shares will arise under contract law from an exercise by D of a right to terminate the contractual relationship for E's non-performance in a continued failure to pay.

Unenforceable (but valid) contractual obligations. Hence another case where liability in respect of an enrichment will be excluded under this Book because the enrichment is justified by reason of the recipient's entitlement under a valid juridical act is where legal rules provide that in given circumstances a contract is valid but unenforceable. The effect is to allow parties to perform their agreement and to prevent recovery of enrichments conferred. That this may result in a windfall benefit is a matter of legislative policy: the absence of a restitutionary claim is intended to provide an incentive to shun conclusion of a contract which will be rendered unenforceable by mandatory rules.

Illustration 19

As a result of X's negligence, E's car is damaged. While the car is being repaired, E hires a car from D. It is agreed that payment of hire charges will not be due until E takes legal action against X to recover compensation. Under the applicable national consumer credit legislation, the agreement to postpone payment of the hire charges constitutes a provision of consumer credit and the hire contract is unenforceable for want of compliance with prescribed formalities. As the contract for use of the car is valid, though unenforceable, D was obliged to make the car available for E's use (though D was entitled to refuse performance). Consequently E's use of the car is an enrichment to which E was entitled under a valid (though unenforceable) contract. E's enrichment is accordingly justified. E is therefore not liable under the law of unjustified enrichment to pay to D a reasonable fee for the use of the car. That D is not able to enforce the contractual right to the agreed counter-performance does not render the enrichment unjustified. This is a matter of policy, rooted in the unenforceability of the agreement. For the like reason the enrichment is not unjustified by virtue of paragraph (4): E, who is to have the benefit of the protection of consumer credit legislation, is to not be regarded as having accepted the enrichment must be reversed in these circumstances for the purposes of sub-paragraph (c) of that paragraph.

Satisfaction of claims subject to prescription. Another case where the existence (but non-exercise) of a right to withhold performance does not affect the underlying validity of the juridical act (and correspondingly the enriched person's entitlement to the enrichment conferred) is that of prescription. Under the rules governing extinctive prescription the creditor's right to claim performance is lost by failing to assert it within time (see Chapter 7 of Book III). The effect of prescription is not to extinguish the obligation, but merely to entitle the debtor to refuse performance (III.–7:501 (General effect)). The fact that the creditor's right to claim performance of an obligation is time-barred does not deny its enduring existence since prescription only affects its enforceability. An enrichment which is obtained by a creditor as a result of the debtor's voluntary performance of a time-barred claim is

therefore a justified enrichment. This rule gives effect to the principle in III.–7:501 (General effect) paragraph (2) that a debtor cannot reclaim a performance simply because it is rendered after the period of prescription has expired.

Illustration 20

D, an events organiser, owes E, a hotel, outstanding sums in respect of accommodation provided to D's clients. After the period of prescription has expired, D responds to a further "final" demand of E's for payment. D cannot reclaim the payment from E. The money has been transferred in performance of a valid contractual obligation, albeit that at the time of performance E's right ceased to be enforceable because prescription entitled D to refuse performance.

Obligations ceasing to have effect for the future only. Where, after an enrichment has been conferred, the juridical act conferring the entitlement to the enrichment ceases to have effect, but (unlike avoidance of a contract) the juridical act does not cease to have effect retrospectively, the enrichment remains justified by virtue of the entitlement under the juridical act. The juridical act has only ceased to have effect for the future. Thus, while a debtor of an outstanding obligation is no longer obliged to perform, a debtor who has performed before the obligation ceased to have effect is still regarded as having performed a valid obligation. Precisely because the right to the enrichment remains intact as regards the past, the enrichment conferred in performance of the juridical act before it ceased to have effect for the future is regarded as a justified enrichment under these rules. (This follows by e contrario reasoning from paragraph (2), which provides that there is no entitlement if the juridical act is retrospectively without effect.) This state of affairs invariably arises in the context of a relationship whose ramifications are to be unwound, if at all, in the special context of that legal relationship. Whatever rights to reversal of enrichment there ought to be will be provided for by the rules governing that relationship. Those rules would not have sliced the effectiveness of the juridical act on a temporal plane (past – effective; future – ineffective) without special cause and without regard to the ramifications. Either there will be a special regime for reversal of benefits or a deliberate policy to leave past benefits where they are. In either case it will be those rules which will determine whether there are rights to recover benefits and, if so, what those rights entail. This Book does not disturb those rights: see further paragraph (3) of VII.–7:101 (Other private law rights to recover). Cases in point are termination of a contractual relationship and withdrawal from or revocation of contracts or other juridical acts.

Void juridical acts. Turning to instances where the juridical act is without effect so that no entitlement to the enrichment can subsist under paragraph (1), a first obvious case is where the juridical act is void ab initio. This is provided for expressly in the wording of paragraph (2). Subject to the other rules of this Book (and in particular the protection of third parties to the transaction under the following article), the enrichment is unjustified and the other party to the transaction will be liable to reverse that enrichment. This principle applies regardless of the ground of invalidity; it is sufficient that an agreement is for some reason void as a contract.

Grounds of invalidity of contracts. Reasons why a contract may be void are not to be found in the law of unjustified enrichment. These are a matter of contract law, both in the general principles of contract law and in the specific rules governing particular types of contract. One reason might be non-compliance with an essential formality requirement. While there is in general no requirement of form for a contract according to these rules (II.–1:107 (Form)), rules relating to specific contracts may, by way of exception, introduce such rules. (See, for

example, IV.G.–4:105 (Form)). Equally a contract may be void as a result of rules governing illegality or the capacity of a party. The latter is relevant not merely to natural persons who are minors or who lack sufficient mental capacity to act, but also to legal persons in so far as the law provides that a transaction beyond its powers is without effect for want of capacity to undertake it.

Voidable juridical acts which are avoided. In accordance with paragraph (2), there is no entitlement under a juridical act to an enrichment if that juridical act is avoided with retrospective effect. For the purposes of enrichment law, an initial validity which retrospectively is inoperable is disregarded. The paragraph makes explicit the proposition that an enrichment is not justified merely because an entitlement to it subsisted at the time it was conferred if, retrospectively, the entitlement is annulled.

Illustration 21

D, a collector of a particular model of cars, negotiates with E for the purchase of a used motor car. He asks E, the owner, which original parts have been replaced and E assures him that only tyres, certain cables and peripheral parts have been changed. In fact, as E knows and has deliberately concealed, several cylinders, some panelling and both wheel axles have been substituted. Taking into account what E has told him, D agrees to buy the car for €32,000, though he would not have bought the car had he known the truth. D later discovers the truth and gives E notice of avoidance of the contract based on E's fraud, returning the car. E's enrichment (receipt of money) is unjustified under this article. The fact that at the time of enrichment (from the standpoint of that moment in time) D was obliged to pay does not render the payment a justified enrichment because the right to payment was annulled with retrospective effect.

Grounds of avoidance of contracts. Grounds of avoidance of contracts are not to be found in the law of unjustified enrichment. These are a matter of contract law. Basic and generally applicable grounds of avoidance of contracts and other juridical acts are to be found in Book II., Chapter 7 (Grounds of Invalidity). There are also specific grounds for the avoidance of specific contracts. For example, a guarantor has a right to avoid a personal security granted after the creditor has breached a pre-contractual duty to inform the guarantor: IV.G.–4:103 (Creditor's pre-contractual duty of information) paragraph (3).

Exercise of right to avoid and failure to avoid a contract. An enrichment can only be unjustified under this paragraph if the entitlement to the enrichment is in fact avoided. As already indicated (see B0), the fact that the disadvantaged person is or was entitled to set the obligation aside will not suffice to render the enrichment unjustified: the bare existence (past or present) of a right of avoidance is not enough. The right must have been exercised. An exercise of the right of avoidance will require the disadvantaged person to give notice of avoidance to the other party to the contract (who need not necessarily be the enriched person) (II.–7:209 (Notice of avoidance) unless the parties have agreed a more liberal mechanism for avoidance (II.–1:102 (Party autonomy))). The right of avoidance may be lost due to lapse of time (II.–7:210 (Time)) or confirmation of the contract (II.–7:212 (Effects of Avoidance) paragraph (2)) or (which may amount to an implied confirmation) pursuit of the alternative remedy of damages for non-performance by the other party (non-accumulation of these remedies being implicit in II.–7:216 (Overlapping remedies)).

Juridical acts otherwise rendered ineffective retrospectively. Avoidance of a contract is not the only manner in which a contract may become ineffective with retrospective effect. The notion of a juridical act “without effect” in this sense extends to any case where legal rules dictate that a juridical act assessed from the standpoint of the time of its creation as valid is rendered of no effect back-dated to the time of creation. A case in point might be where parties to a contract agree that the effect of a given condition being fulfilled is to render their agreement null and void from the outset. A contractually agreed retrospective effect of a resolutive condition might fall within paragraph (2) – with the consequence that an enrichment obtained by one party is unjustified in relation to the party which provided it. Of course in such cases it is possible that what is agreed is not that the contract is of no effect, but rather that there is a (contractual) right to a return of benefits conferred. In that case there is a mere modification of the obligations under a contract (from counter-performance to restitution) in the same manner as termination of a contractual relationship: the contract remains valid, but the terms of the obligations are transformed. If that is so, the enrichments resulting from prior performances remain justified because the contract is not “without effect”. The matter is one of contract law and enrichment law does not come into play.

Illegal contracts which are without effect. Particular care is required in relation to enrichments conferred pursuant to contracts which are vitiated by illegality. II.–7:301 (Contracts infringing fundamental principles) and II.–7:302 (Contracts infringing mandatory rules) set out a range of possible effects on the validity of a contract, depending on the particular illegality in question. Where the contract is declared to have been of no effect – that is to say, the contract is regarded as having been void ab initio – the reasoning set out above regarding void contracts applies. This is the situation with respect to contracts contrary to principles recognised as fundamental to the laws of the Member States of the EU: see II.–7:301 (Contracts infringing fundamental principles). If, at the other extreme, the contract is declared to have full effect, there is no difficulty: this is simply a valid contract and the enrichments resulting from a due performance of the contract will be justified on the basis of an entitlement to the enrichment under a valid juridical act. Where the contract is merely declared to be modified, there is no retrospective ineffectiveness and the contract is not “without effect”. The enrichments arising from performance of the contract will again be justified accordingly. Any right to reversal of such enrichments – for example because a right to a counter-performance is converted by considerations of public policy into a right to restitution – will be governed entirely by contract law. The same holds where the contract has partial effect in the sense that it gives rise to an obligation but no corresponding right to performance: this is merely a particular case of an unenforceable obligation where the debtor has a right to refuse performance (as to which, see Comment B). A further possibility is that the contract vitiated by illegality is in effect voidable, since it may be impeached by only one party (the party for whose protection the rule on illegality exists). In that case the situation is the same as for contracts voidable on any other basis.

Suspensive conditions not fulfilled. A juridical act may be created on the basis that it is subject to a suspensive condition – in other words, it is conditional upon the occurrence of an uncertain future event so that the rights and obligations take effect only if the event occurs: see III.–1:106 (Conditional rights and obligations) paragraph (1). Usually some period of time – either a fixed or ascertainable period or, if no particular definite or indefinite period is envisaged, a reasonable period of time whose parameters are determined by the nature of the condition or policy considerations – is prescribed by the parties or legal rules as the period during which the condition must be satisfied in order for the rights and obligations to take effect. At some stage it will emerge that a condition which has hitherto not been fulfilled is no

longer capable of fulfilment. Where for any reason the condition cannot be fulfilled (that is to say, a party may treat the condition as not having been fulfilled (see III.–1:106 (Conditional rights and obligations) paragraph (4)) or has become impossible of fulfilment), the conditional right can no longer become binding. Any enrichment which has been obtained by performance of the corresponding conditional obligation while it was in suspense and before it irretrievably failed to become binding is to be regarded, in accordance with paragraph (2), as an enrichment obtained as a result of a juridical act which is without effect. The benefit received by the other party to the contract is without justification.

Illustration 22

D sends to E1 and E2 a wedding present in view of their prospective marriage. On the eve of the wedding the relationship between E1 and E2 irretrievably breaks down when E2 discovers E1 has been concurrently involved with another woman. The wedding is cancelled. D's gift was expressly or impliedly subject to the suspensive condition that E1 and E2 were to marry. Accordingly D's gift is without effect. The enrichment of E1 and E2 by D is unjustified. D can demand a return of the present.

(e) Entitlement as against the disadvantaged person

Entitlement as against third party insufficient. In order for an enrichment to be justified it is essential that the entitlement to the enrichment is an entitlement against the disadvantaged person. An enrichment is not justified merely because the enriched person has contracted for it if the contract is not with the disadvantaged person. Where, for example, funds are mistakenly credited to a wrong bank account, the account holder's enrichment is not justified in relation to the transferor or depositor of the money merely because the account holder is entitled to the sum as against the account holder's banker.

Protection of persons dealing with non-entitled third parties in good faith. However, an enriched person who has paid a third party in good faith for the benefit received is deserving of protection. Moreover, there is a public interest in the commercial circulation of property, which is impeded where an acquirer in good faith cannot rely on the apparent 'title' of a seller of goods or services. This consideration is taken care of in two ways under this Book. Firstly, there may be an entitlement to the enrichment by virtue of a rule of law (as to which, see below). Secondly, VII.–6:102 (Juridical acts in good faith with third parties) makes provision for cases where the enriched person is an innocent party deserving of complete exculpation from unjustified enrichment liability by virtue of dealings for value and in good faith with a third party. Finally, in any case to which that defence is not available (e.g. because the enriched person has not paid a third party in order to receive the benefit), good faith may nonetheless operate to limit liability, either on the basis of the defence of a change of position under VII.–6:101 (Disenrichment) or even where the third party has not made any countervailing outlay if the enrichment can only be reversed by a monetary payment (on the basis of VII.–5:102 (Non-transferable enrichment)).

Illustration 23

X, a caretaker of a building employed by D, lets out a vacant flat rent-free to a friend E. E was unaware that X did not have the authority of his employer to let out the flat. D claims rent from E for the period of her occupation of the flat. E's enrichment is not the result of any entitlement against D, since in so far as he purported to let out the flat on D's behalf or with its permission X, who had only custody of the flat, acted with neither express, implied nor apparent authority. E's enrichment is justified as against

X, but this does not justify the enrichment in relation to D. However, what, if anything, E is liable to pay D in reversal of the unjustified enrichment will depend on the application of VII.–5:102 (Non-transferable enrichment).

Illustration 24

E, a butcher, purchases pork from X, which (unknown to E) has been stolen from D's supermarket. The pork is rendered into sausages and sold to E's customers. Under the governing property law, since the pork was stolen, E acquired no property in the meat under the contract of purchase with X, but acquired ownership (and was correspondingly enriched by an increase in assets) as a result of processing the meat and rendering it into sausages. However, since E was not entitled to this enrichment as against D it is unjustified in relation to D. The fact that E transacted with X in respect of the meat does not justify E's enrichment, but may enable E to establish the defence under VII.–6:102 (Juridical acts in good faith with third parties).

Discharge of one solidary debtor by another. A particular case where the satisfaction of one person's entitlement may enrich another who is not entitled to the enrichment is where one solidary debtor discharges more than its share of the debt. That situation can arise because, as against the creditor, each solidary debtor is bound to render the performance in full (see III.–4:102 (Solidary, divided and joint obligations) paragraph (1)). If the creditor obtains performance from one of a plurality of solidary debtors, the entire debt is discharged. The creditor's enrichment is justified in accordance with this article because of the entitlement to payment in full from any of the debtors. However, the same is not true of the enrichment of the co-debtors, whose share of the debt has been discharged by the performing debtor: the discharge of their liability to the mutual creditor is not justified by any entitlement in the sense of paragraph (1)(a) because no debtor has a right against the co-debtors for payment of that debtor's share; in the internal relationship between the co-debtors, each is liable for the appropriate share. An entitlement to contribution is provided for within the law governing the internal relationship of solidary debtors set out in Chapter 4 of Book III – specifically under III.–4:107 (Recourse between solidary debtors). That rule is unaffected by this Book in accordance with VII.–7:101 (Other private law rights to recover).

C. Justification under a court order or rule of law

(a) General

Entitlement under a court order or rule of law. Subject to the qualification in paragraph (3) and the possible application of paragraph (4) (see A0-0) above), an enrichment is also justified (under paragraph (1)(a)) if, as against the disadvantaged person, the enriched person is entitled to it by virtue of a court order or rule of law.

Court order. A court order will ordinarily give effect to an entitlement or exercise a judicial discretion, provided for by law, which has the effect of conferring an entitlement. An entitlement under a court order provides a justification for an enrichment because the policy considerations which might ordinarily require recompense for the advantage conferred on the benefited party do not arise or have already been addressed by the legal rules which prompted or authorised the making of the order. It remains important, however, to identify the precise scope and effects of the court order since any patrimonial transfer beyond its terms and unsupported by it is in principle unjustified.

Illustration 25

An unmarried cohabiting couple separate. A court order made under the applicable family law grants the woman the terraced house belonging to the man. The court order transferring the home does not preclude a claim under this Book in respect of the woman's use of the house after separation and before title is transferred.

Illustration 26

An insurance company is obliged under the terms of an order made by an appellate court to pay a policy holder €100,000 and it complies with the court order. The final court of appeal subsequently sets aside the decision of the lower appellate court and reduces the amount payable to €50,000. The insurer may demand restitution of the overpayment of €50,000.

Rule of law in general. The source of the legal rule is immaterial. The term “rule of law” is intended to be understood in a neutral and undogmatic sense embracing primary and secondary legislation and rules recognised or applied in judicial decisions.

Extra-contractual obligations. Entitlement by virtue of a rule of law includes an entitlement to reparation, reversal of an enrichment, a handing over of profits and other remedies under the law on non-contractual liability arising out of damage caused to another, unjustified enrichment, benevolent intervention in another's affairs and other legal relationships arising by operation of law.

In particular: benevolent intervention. This paragraph also has the effect of excluding from the law of unjustified enrichment those enrichments which are conferred on the enriched person as the result of a benevolent intervention in the enriched person's affairs. Intervention in another's affairs may be regarded as an enrichment of the principal: the principal benefits from the service rendered or the work done by the intervener. There is a corresponding disadvantage of the intervener who provides the service or does the work. Nonetheless, independent of paragraph (1)(b), a benevolent intervener has no claim under this Book for the value of services or work benefiting the principal because the principal is entitled to that benefit on the basis of a rule of law. The benevolent intervener's sole claim to recompense for rendering the service is under the rules of benevolent intervention, which restricts a right to remuneration to those cases where “the intervention is reasonable and undertaken in the course of the intervener's profession or trade” (V.-3:102 (Right to remuneration)). That claim is unaffected by these articles: see VII.-7:101 (Other private law rights to recover).

Requirements of benevolent intervention. The exclusion of an intervener's claim on this basis presupposes that, as regards the activity which has resulted in the enrichment, the particular requirements for a (justified) benevolent intervention are satisfied (as to which see V.-1:101 (Intervention to benefit another)). Those requirements will not be satisfied if intervention is officious, that is to say without good reason (for example, because it was knowingly conducted in contravention of the principal's wishes), or was conducted primarily for reasons other than to benefit the principal (for example, because the intervener sought chiefly to appropriate benefit for himself or herself). On the other hand it should not be overlooked that the absence of a reasonable ground for intervening is not fatal to the existence of a benevolent intervention if the principal subsequently approves the act without delay detrimental to the intervener. The potential for ratification makes it possible for an intervention to be characterised in law, with retrospective effect, as a benevolent intervention.

Effect of the rule. The effect of the provision in this Book is to confine the benevolent intervener (the disadvantaged person) to the rights conferred by the law of benevolent intervention in another's affairs. The exclusion of the law of unjustified enrichment prevents the latter from undermining the values enshrined in the former.

Illustration 27

Seeing flames through a window, D rushed to put out with a fire extinguisher a fire which threatened to take hold in the house of a neighbour, E. D has rendered a service to E. E is accordingly enriched by receipt of the service. However, D has no claim under this Book against E. D conferred the enrichment in the course of a benevolent intervention in E's affairs. Any right of D against E is governed by the law of benevolent intervention.

Rationale. Were the law of unjustified enrichment to apply, an intervener might assert a claim to payment of the value of that service or work. Under the law of benevolent intervention in another's affairs, however, the intervener does not necessarily have a claim for the value of work done. In general, so far as the service rendered is concerned, the intervener is to be regarded (in keeping with the benevolent intention) as essentially conferring a gratuity on the principal, having only a claim for reimbursement of expenditure (or indemnification for obligations incurred): see V.-3:101 (Right to indemnification or reimbursement). Only where the intervention is conducted in the course of the intervener's profession or trade does the intervener have a claim to remuneration equal to the value of the performance undertaken: see V.-3:101 (Right to indemnification or reimbursement). Conversely, an enrichment claim might well be restricted in the circumstances of the case (where typically the principal has not consented to or authorised the intervention) to a mere claim to the principal's patrimonial saving: see VII.-5:102 (Non-transferable enrichment). The difference between a claim to the value of the service rendered and the principal's actual patrimonial saving will be significant where the intervention was conducted properly, but failed to achieve the desired object.

Significance of ratification. This differential treatment of work done in the course of benevolent intervention highlights the significance of ratification. In converting an intervention into a benevolent intervention, approval of the act done by the intervener destroys any enrichment claim which the intervener might have and generates instead a claim under the law of benevolent intervention, so far as the latter affords one. The exact circumstances of the case will determine which of principal and intervener ultimately benefits from this transition from one set of principles to the other.

Entitlement under property law rules. An entitlement by virtue of a rule of law will typically take the form of a right under property law which is effective against third parties generally - and thus against the disadvantaged person, even if the enrichment has not resulted from any involvement of the disadvantaged person.

(b) Entitlement to the benefit of the enrichment under a rule of law: paragraph (3)

General. The mere fact that a rule of law has entitled an enriched person to an enrichment and that that entitlement is effective against the disadvantaged person does not in itself justify the enrichment. The entitlement must be such that the enriched person is immune from liability under this Book because the rule of law entitles that person to the benefit of the enrichment - the right to retain it without liability to compensate for the gain. For these purposes it must be appreciated that entitlements under a rule of law have differentiated significance, depending on the nature and context of the rule.

Enrichment with liability under other rules. In one set of cases, a right to reversal of the enrichment or to some compensatory transfer is provided for under other rules of private law. A right under this Book would at best merely duplicate and at worst contradict that other regime and is accordingly excluded by regarding the enrichment as justified. Since in such cases the statutory or other rules authorising the enrichment have simultaneously fixed the quantum of liability, it would contradict those rules to set a different tariff under this Book. They confer an entitlement to the benefit of the enrichment because they stipulate the terms of that entitlement.

Illustration 28

Statute provides that where a gratuitous performance of a dramatic work is undertaken (other than in and for the benefit of a school) a reasonable fee is to be paid. Whether this is a fee to be assessed according to market principles or whether considerations of social purpose, fairness or equity may play a role in determining the proper level of the fee is a matter of statutory interpretation. Whatever the proper construction of this statutory rule, the enrichment of the performers is justified under this article because the statute provides a mechanism which is implicitly a complete regime for compensation of the copyright holder. An alternative liability under this Book, which might exceed the statutory liability, contradicts the purpose of the statutory rule because that rule is intended to set the level of compensation due for the enrichment obtained.

Enrichment without liability. In other cases, for reasons of policy, no compensation is awarded at all under the regime entitling the recipient to the enrichment. It is the intention of the statutory rule that the enriched person should enjoy a windfall – an enrichment without obligation to account for it. The effect of this Article in such a case is to exclude a right to reversal of the enrichment under this Book (subject to paragraph (4)) and so to confer a positive right to retain the enrichment without any obligation to account for it. Again the enriched person is to be regarded as being entitled under the rule of law to the benefit of the enrichment.

Exclusion of enrichment claim need not be explicit. It is immaterial whether the statute or other rule of law or the court order indicates explicitly that the entitlement to the enrichment carries the benefit of that enrichment. An entitlement to the benefit will arise whenever liability under enrichment law would contradict the purposes of the legal rule or court order. It is enough if this contradiction is implied or can be deduced by inference, based on an assessment of the function of the statute or other legal rule, or the court order.

Entitlement to enrichment, but subject to liability under this Book. On the other side of the line stands the case where there is a right to have the enrichment by operation of legal rules, but the statutory regime is silent on the question of accounting for the benefit and liability under this Book would not contradict the entitlement to the enrichment. These are cases where there is nothing in the legal rule and its context which dictates that the enriched person should not be liable as a matter of the law of obligations to reverse the enrichment conferred by operation of law; the rule itself does not negate the notion that the benefited party should pay for the benefit gained. In other words, the entitlement under the rule of law is based on considerations of legal certainty or simplification or to protect the position of third parties and there is nothing in such considerations which also implies that the entitled party should have an economic benefit as well.

Illustration 29

The social security department pays child benefit to M, the mother of the child J who is recorded in a social register as being entitled to receive the sum on behalf of J. In fact, following a divorce, the father F has custody and consequently also the right to receive the child benefit. M is obliged to pay the benefit received to F because the registration in the social register is of a purely formal character and does not confer any substantive justification for retention of child benefit payments in relation to the person who is entitled to custody.

Transfer of title rules. Property law rules which stipulate that title is to transfer to another in given circumstances – such as the rules on acquisition in good faith from non-owners and the rules on mixing and accession – provide a case in point. They confer an entitlement on the enriched person: as a matter of property law – in relation to the disadvantaged person as well as others – the enriched person is the holder of the property right in the asset concerned. This in itself, however, does not dictate that the enriched person who has acquired a property right under a rule of law should necessarily be immune from an enrichment claim. The entitlement must be such that it precludes personal liability under enrichment law to account for the benefit obtained. Whether a given rule of property law merely passes formal title without intending to address the economic balance between the parties concerned or whether it also intends to confer real benefit in addition depends on the particular rule and the reason for the law recognising a transfer of title in the circumstances. Where title to another's property has been obtained without sacrifice on the part of the acquirer, the starting point may be the assumption that only a nominal and not a substantive entitlement is conferred, so that the enriched person should account for the windfall unless there are other policy considerations encapsulated in the rule on transfer of title which point against liability under this Book. Conversely, property law rules which are intended to protect a purchaser or one who has already sacrificed something of value to obtain the enrichment may be taken as a rule as entitling the enriched person to the benefit of the enrichment. That remains so if the property law rules themselves provide for some mechanism whereby a divested owner can reclaim property from a good faith acquirer on satisfying some condition (e.g. compensating the acquirer) because such a regime clearly assumes there is otherwise no (contingent) liability to give up the acquired benefit.

Illustration 30

X hires from D musical equipment. X subsequently sells the equipment to E. That X was not entitled to dispose of the equipment does not affect the validity of X's contract with E: see II.–7:102 (Initial impossibility). Under the applicable rules of property law, E acquires property in the equipment by virtue of E's purchase in good faith and for value. E's enrichment is justified in relation to X because E was entitled to it as against X by virtue of the contract with X. While E's contract with X does not as such entitle E to the enrichment as against D, E's enrichment is also justified as against D by virtue of the property law rules governing acquisition in good faith (which have been brought into play by D's purchase from X). Those rules entitle E not only to title to the property formerly vested in D, but also to the benefit.

Unsolicited goods sent to or services rendered to a consumer. A second instance where a right to the benefit of the enrichment and a corresponding exclusion of enrichment liability arises from the rule that where unsolicited goods are sent to a consumer by a business (and likewise where unsolicited services are rendered) the consumer is not as a rule liable in respect of the supply: see II.–3:401 (No obligation arising from failure to respond), which

takes up the principle in EC Directive 97/7. Paragraph (1)(b) of that provision explicitly provides (for the case where the goods or services are not supplied in error or similar circumstances) that “no non-contractual obligation arises from the consumer’s acquisition, retention, rejection or use of the goods or receipt of benefit from the services”. That excludes liability under this Book.

Illustration 31

A consumer receives unsolicited goods which have been deliberately sent through the post by a business enterprise in the course of its professional activities with the intent of inducing the consumer to pay for them. No liability arises under this Book.

Discharge of bankrupt. A further case where enrichment liability will be expressly or impliedly excluded by statutory rules is where a bankrupt is discharged of outstanding debts as a result of the process of bankruptcy.

Illustration 32

As a result of rules of bankruptcy, a bankrupt is discharged of all debts. The bankrupt is enriched thereby because of the decrease in liabilities. The creditors are disadvantaged by a corresponding decrease in assets since their claims against the bankrupt are extinguished. This enrichment is justified by virtue of the rules on bankruptcy. The bankrupt is entitled to the benefit of the enrichment under a rule of law (the statutory rules on bankruptcy). It would contradict the purpose of those rules (indeed a primary function of bankruptcy) if the bankrupt were to come under a fresh liability to pay the former creditors the debts which have been discharged by operation of the statutory rules.

Acquisitive prescription. Another case where liability under this Book is impliedly excluded by statutory rules is where a person acquires a right by prescription. Property law rules enabling a person in adverse possession to obtain an indefeasible title to property over time aim to promote legal certainty and to encourage right-holders to assert their entitlements promptly. Such rules would be undermined if the law of unjustified enrichment were to enable the former owner to assert a claim under the law of obligations for a return of the property which legal rules have vested in the new owner. This would effectively extend the period over which a dispute as to ownership could be conducted, contrary to the goal of setting a prescribed time period for such disputes.

Statutory rights to encroach on property rights. There are many cases where legislation provides, in the broader public interest, for encroachments on the property of another. These may well amount to authorisations to make use of another’s property and thus to obtain an enrichment. Often it will be explicit or implicit that the authorised encroachment is not one for which the persons authorised are liable to give an account of the benefit obtained.

Illustration 33

An enactment provides that persons who need to enter adjacent land in order to carry out works to their own land, but who do not have consent to enter that adjacent land, may apply to court for a court order authorising access. Statute provides that the terms and conditions of the access order granted by the court may include a provision requiring the applicant to pay a fair and reasonable sum as consideration for the privilege of entering the land, unless the works are to be carried out to residential land. E obtains an access order enabling her to effect repairs to her home by entering D’s

land. Although E may use D's land in entering on it and making repairs from there, E's enrichment is justified: E is entitled to do so under a court order; and since the statute precludes in such circumstances an obligation to pay a fee for the privilege as a term of the order, an equivalent liability under enrichment law is likewise excluded. E is entitled to the benefit of the enrichment.

Further examples. It would be extremely arduous to compile a complete list of those instances within the scope of this Article where the entitlement to the enrichment is such that any liability to make restitution or pay compensation to the disadvantaged person is explicitly or implicitly excluded. The following further illustrations can serve only to outline the practical width of this provision.

Illustration 34

Statutory provisions permit teachers to make anthologies for specified educational purposes of limited amounts of certain types of published material which is subject to copyright. Although teachers who exercise this privilege (and their employers) make use of another's asset (namely, the copyright enjoyed by the copyright holder), their enrichment is justified under this Article. The purpose of the statutory provision is to promote the use of literature in education and to relieve educational institutions of the burden of acquiring (potentially costly) permission to make copies. The purpose of the statutory provision would be defeated if teachers (or their employers) were to be obliged under this Book to pay a reasonable fee for making copies. The legislation intended their enrichment to be as of right and gratuitous and thus also to confer the benefit of the enrichment.

D. Consent to the disadvantage: paragraph (1)(b)

(a) Consent to the disadvantage

Meaning of consent. Consent for the purposes of this Article means a bare consent. However, a consent to a disadvantage only justifies an enrichment if that consent is not vitiated by matters such as fraud, threats or unfair exploitation – in other words if it is a consent which is freely given. A further requirement is that the consent be “without error”. Consent includes the case where a person sustains a disadvantage as a result of acts or omissions of another which the disadvantaged person has authorised.

Deliberate enrichment of another. Accordingly a disadvantage will be sustained with consent if the disadvantaged person has acted knowingly to confer the enrichment or has authorised a third party to effect this.

Incidental benefit to others from acts within own sphere. Since it is consent to the disadvantage rather than agreement to the enrichment which establishes the justified nature of the enrichment under paragraph (1)(b), cases of incidental benefit to others resulting from the pursuit of one's own interests will as a rule be justified enrichments. Where people act to advance their own affairs, within their own property sphere, they consent to their side of the disadvantage-enrichment equation. The fact that others may be enriched as a result and that that outcome was neither intended nor envisaged is immaterial.

Illustration 35

D, a landowning company, establishes an irrigation system for the benefit of its land. That system also happens to improve the irrigation of adjacent land belonging to E. E's enrichment (in so far as D has done work which benefited both D and E) is not unjustified under this article because D undertook the work voluntarily and thus consented to doing the work. D's ignorance of the fact D was coincidentally benefiting E does not amount to an error.

Similarly, a squatter who improves property to make it more comfortable, knowing it belongs to another (and who therefore makes no mistake as to title), will do so at his or her own risk. There is consent to the disadvantage which results to the benefit of the landowner.

(b) Error

General. Paragraph (1)(b) provides that an enrichment is not justified by consent to the disadvantage if that consent is affected by error. While the error may be either of fact or law (see below), it must be causative of the disadvantage and not merely coincidental (see D0). It is also important to distinguish between mistakes as to an existing state of affairs (which are errors in the sense of these rules) and mere mispredictions as to possible future outcomes or events: see D0.

Error of fact or law. The disadvantaged person's error may be either of fact or of law. This is in keeping with the spirit of the rules on mistake in contract law where mistakes of either fact or law may be operative to generate a right to avoid the contract (II.-7:201 (Mistake) paragraph (1)). There seems to be no compelling reason why any distinction between errors of fact and errors of law should be made in the context of enrichments conferred otherwise than in satisfaction of rights under valid juridical acts.

Inexcusable errors. There is no requirement that the error be excusable (i.e. neither self-induced nor grossly negligent). Where the error is not obvious to the enriched person, the disadvantaged person will in any event carry the risk that the enriched person has or acquires a defence to the claim (in particular: by virtue of a subsequent disenrichment in good faith). Gross negligence in making an error may be relevant to the plausibility of the claimant's case that the claimant was actually in error when the enrichment was conferred, but this is a matter for the tribunal finding the facts. Admittedly, the excusable or inexcusable nature of a mistake is material in limiting the right to avoid a contract (see II.-7:201 (Mistake) paragraph (2)(a)), but this further restriction may be of limited import. (Comment J to that article emphasises the importance of the other contracting party's state of mind and this suggests that the provision overlaps extensively with the requirements in II.-7:201 (Mistake) paragraph (1)(b).) Moreover, that restriction is merely part of the general logic that contracts are not lightly to be unravelled and that one party should not be able to escape a bargain primarily on the basis of that party's own carelessness. By contrast, an "inexcusable" error is largely only relevant to the law of unjustified enrichment when there is no contractual or other entitlement which can justify the enrichment; if there is a binding juridical act, whose efficacy is unaffected by the mistake, the mistake will have no bearing and (unless paragraph (4) applies) the enrichment will be justified: see A0. This provision is thus largely concerned with the cases where there is no binding contract between the parties which governs the enrichment. Indeed, it will usually be the case that by virtue of the disadvantaged person's (careless unilateral) mistake, the enriched person has simply received a windfall. In that context the legitimate expectations of the other party are less extensive in comparison (they can relate only to the legitimacy of the enrichment, not a whole legal relationship) and are adequately safeguarded by circumscribing

the extent of liability (especially where the enrichment can only be reversed by monetary payment) and by broad defences (especially that of change of position in good faith reliance on the apparently justified nature of the enrichment).

Unilateral errors. There is equally no requirement either that the error be bilateral or that the enriched person should have been aware of the error. The knowledge, actual or constructive, of the enriched person that the enrichment is being conferred in error is not relevant to the absence of justification for the enrichment. Of course the principle is expressed in II.–7:201 (Mistake) paragraph (1)(b)(ii) (in the case where the other party neither caused nor shared the same mistake) that a contract is not to be thrown over if the other party had no cause to know of the mistake. This protects an innocent party from being ‘surprised’ by an obscure (that is to say, private or secret) mistake made by their counterpart. However, that is again in the context of determining whether a contract is binding. Such a restriction is not intrinsically compelling where, as here, an enrichment is often conferred outside the context of a (void or valid) contract. The policy concern outside the contractual context is a narrower one, namely that the consequences of a unilateral mistake should not be shifted to an innocent party to the latter’s detriment. Again, therefore, an absence of knowledge of the error on the part of an innocent recipient is a reason for protecting the enriched person, for example, if the enrichment cannot be reversed except by payment (because the enrichment is by its nature not transferable) or because the enriched person has sustained a disadvantage in reliance in good faith on the supposition that it was permissible to retain the enrichment without liability to account for it. The concern to protect the innocent recipient is not a sufficient reason for allowing enriched persons a windfall if they are able, without pain, to reverse the enrichment. Such considerations are therefore properly addressed by the rules governing the extent of liability and the existence of defences, rather than by categorising the enrichment as justified at the outset, and in this draft are taken up in later articles of this Book: see VII.–5:101 (Transferable enrichment) and VII.–5:102 (Non-transferable enrichment). It must be remembered that if the error is truly causative, the only reason the enriched person has obtained the enrichment is because of the claimant’s error; the enriched person was never ‘truly’ meant to have it. As a matter of principle this is the proper test of justification.

Requirement of a causative error. The enrichment must have been conferred on the basis of an error. Whatever the nature of the error, it must be causative in a ‘but for’ sense if the consent is not to justify the enrichment. The fact that the claimant was mistaken as to some present fact or legal position at the time of the enrichment will not be relevant if the enrichment would still have been conferred even if the disadvantaged person had not been mistaken. Mere ignorance of a true state of facts or law is consequently not an error relevant to paragraph (1)(b). There is an additional requirement that knowledge of the true situation would have modified behaviour so as to forestall the disadvantage being sustained.

Awareness of disadvantage, but error as to terms. The requirement that the error be causative does not mean that paragraph (1)(b) is inapplicable simply because the claimant was fully aware of sustaining a disadvantage. In the usual cases involving error the disadvantaged person will indeed appreciate that some sacrifice is being made. The disadvantage will be triggered by an error as to who is being enriched or as to the extent of the enrichment being conferred on an intended beneficiary.

Illustration 36

By mistake D pays money into E’s bank account. D intended to pay creditor X, but by mistake entered E’s details on the deposit slip. E’s enrichment is obtained as a result of

an error by D within the terms of paragraph (1). D (it is assumed) would not have given the instruction for that transfer had D appreciated that it was E and not X (whom D intended to pay) who stood to benefit from the transfer. The fact that D would still have parted with the same sum had the instruction been completed properly (because D would have paid X) is immaterial.

Illustrative types of relevant error. In broad terms there may be error as to who is being enriched (misdirected performance), or the extent of the enrichment (excessive performance), or the reason for the enrichment. Typical errors may therefore include the following scenarios. Firstly, there may be a flawed assumption by the disadvantaged person of an obligation to confer the enrichment on the enriched person, although there is in fact no question of an obligation to do so. For example, a person who pays a debt twice is mistaken when paying for the second time in supposing that there is an obligation to pay. It will be irrelevant whether the disadvantaged person supposes that there is an obligation to the enriched person to confer the enrichment. The belief might well be that there is an obligation to a third party to enrich the enriched person. Secondly, a claimant may have wished to benefit a third party whom the claimant supposed was bound to perform an obligation to enrich the recipient. The claimant may thus have wrongly assumed that in enriching the recipient the claimant was discharging an obligation of the third party. Thirdly, the disadvantaged person may be mistaken as to the identity of the person being enriched (e.g. where wrong account details are entered in transferring money between bank accounts) or as to the extent of the enrichment being conferred (e.g. where the wrong sum is entered in a bank transfer).

Compromises and submission to doubtful claims. A case of potential difficulty is where one party makes a transfer in order to end or avoid a dispute. There is no difficulty where the compromise amounts to a juridical act (contract). In that case there will be an entitlement on the part of the recipient based on the terms of the compromise. We are concerned here with residual cases in which payment and acceptance of the payment do not amount to a juridical act. Explicitly or implicitly, the would-be creditor making the demand asserts that the disadvantaged party is under an obligation to confer an enrichment (e.g. to make the payment invoiced). The supposed debtor, it is assumed, has, at the very least, some doubt about the apparent creditor's claim (that is to say, the existence or extent of any obligation) and, in some cases, may hotly contest this. The "debtor" nonetheless complies with the demand and makes an unconditional payment. It is subsequently established that the creditor was not in fact entitled. (Where the creditor was entitled in part, but not to the extent demanded, the same question is raised *pro tanto*.) In such circumstances the transferor will not generally be able to show that the transfer was made in error. Usually the disadvantaged party will have paid simply to avoid the aggravations that would arise from creating a confrontation or from prolonging a dispute. The transfer is made from reasons of greater convenience, on a cost-benefit analysis, to dispose of the demand, to avoid the irritation of on-going controversy and perhaps avert the threatened prospect of litigation. In such a case the payer has not made the payment with and because of a belief that there is an obligation to do so as such. There has been no causative error involved precisely because in making the payment or agreeing to a compromise the payer was not acting under the false impression that there was any obligation to pay. The payment is made not because of the supposition of an obligation, but rather because of the intransigence of the demand. For the payer it may ultimately have been immaterial whether there was in fact an obligation; what was decisive was the annoyance of the allegation and it was to eliminate the nuisance (not the obligation as such – whose very existence may have been contested) that the enrichment was conferred. It will therefore be immaterial in those circumstances whether the payer privately considered all along that there was no obligation, or considered the matter was unclear and had no decided view of the issue,

or had in the end inclined towards the view which the other party had alleged. The payer's belief as to the existence of the obligation has simply ceased to be the determining factor in conferring the enrichment. The determining factor is rather the presence of the demand. The same principles will apply if the transferor had a suspicion that there was no obligation to pay, but (whether from laziness or for other reasons) has declined to make further inquiry into the matter. In that case there is an affirmative belief that there is no obligation, but this is again coupled with a doubt and the fundamental motivation for the transfer (to eliminate the demand) is again decisive. The case is of course otherwise if the payment is made with a reservation, since in that case there is no settlement of the demand and an indication that the supposition of an obligation is the entire basis for the enrichment.

Mispredictions. An error within the scope of paragraph (a), whether of fact or law, must be as to a present matter. This provision does not embrace mere mispredictions of future outcomes. An error as to a present matter includes, for example, errors as to another party's intentions (this being an error as to their present state of mind). By contrast, an erroneous anticipation of how another will behave is not an error within this paragraph. It is a mere misprediction of a future event. An enrichment conferred with some express or secret hope that it will induce or lead to a given outcome is not conferred under a mistake of present fact. Rather it is a mistaken anticipation of a future state of affairs, a misjudged expectation. As such it constitutes a mere misprediction and not an error within the meaning of paragraph (1). The exclusion of mispredictions is implied by the special conditions attached to paragraph (4). If a misprediction sufficed to nullify consent to a disadvantage, then an enrichment could be unjustified according to paragraph (1)(a) – notwithstanding a supporting legal basis - so by-passing in such instances (i.e. where there is no valid juridical act in the background) the stringent requirement that the enriched person must have known of the failed purpose or disappointed expectation.

(c) Absence of consent

Categories of enrichment without consent. A prime instance of absence of legal justification for an enrichment (falling within paragraph (1)) is where the enrichment is obtained from the disadvantaged person without the latter's consent to the loss of property or use of rights. Broadly three types of situation may be envisaged where this may occur. These are (i) where an act of nature has effected the enrichment, (ii) where a third party, such as a stranger or other intermeddler acting without authority, has effected some transfer of value (i.e. has extracted benefit from the disadvantaged person and passed that benefit on to the enriched person), and (iii) where the enriched person has extracted benefit from the patrimony of the disadvantaged person without the latter's permission. In the latter case the acts of the stranger or the enriched person may or may not be in bad faith and interference with the claimant's rights need not necessarily be tortious.

Illustration 37

E uses a photograph of D, an internationally renowned footballer, in its advertising promotion to launch a new beverage. The company did not contact D to obtain his permission for the use of his image and name in the endorsement of the product. D's disadvantage in suffering the use of his rights of personality is without his consent. The enrichment of the E company is unjustified under this article.

Illustration 38

Sheep belonging to farmer E break through a hedge at the boundary of D's land and graze on D's pastures. D's disadvantage in (unwittingly) providing grazing for E's sheep is without D's consent. D's enrichment of E is unjustified under this article.

E. Purpose not achieved; expectation not realised: paragraph (4)

(a) General

Overview. Paragraph (4) provides that an enrichment which the disadvantaged person has conferred in order to achieve some purpose or for the fulfilment of some expectation is unjustified in specified circumstances if the intended purpose is not achieved or the expectation is not fulfilled.

Relationship to paragraph (1). This article only sets out circumstances in which an enrichment is unjustified. It operates to enlarge the ambit of "unjustified", buttressing the rule in paragraph (1). Accordingly an enrichment which is unjustified under paragraph (1) is unaffected by this provision. (Indeed an enrichment may be unjustified under both provisions.) Where, however, an enrichment is justified according to paragraph (1), it may nonetheless be unjustified according to paragraph (4) so as to support an enrichment claim (notwithstanding that there was an entitlement to the enrichment under a juridical act or rule of law). This will be in limited cases only, however, since a mere disappointment of an expectation or frustration of a purpose which a (valid) juridical act was intended to fulfil will not form the basis for a claim under this Book if the rules governing the juridical act itself constitute a complete regime governing rights to recover benefits conferred (e.g. by termination of a contractual relationship). See further VII.-7:101 (Other private law rights to recover).

Illustration 39

D makes a payment to E. The purpose of the payment, as disclosed by the documentation for the transaction, is to benefit X by discharging a debt which X owes to E. E notifies D, however, that the payment is not accepted in discharge of X's debt. X has not authorised the payment and fails to ratify it. It is assumed that in the circumstances D's payment does not discharge the debt which X owes to E. E's enrichment obtained from D is unjustified under paragraph (4). This is so even though D made no mistake (D knew he was not obliged to make the payment) and merely mispredicted that E would accept the payment as a discharge of X's debt, so that D consented freely to the disadvantage.

(b) Conferment for a purpose not achieved or with an expectation not realised: sub-paragraph (a)

General. The typical instance of a purpose or expectation which forms the basis for one person enriching another is the expectation of some reward for doing so, whether in exchange or as a consequence. However, the provision is not confined to cases in which the enrichment was conferred with a view to a counter-enrichment which ultimately does not materialise.

Illustration 40

A father F helps his daughter's fiancé, E, by making substantial contributions towards construction of the latter's house which is to be the future matrimonial home. The

young couple's relationship breaks down; they separate shortly before the marriage is due to be concluded. The purpose of the contributions made by the father, namely to contribute to his daughter's future matrimonial home, is frustrated. F can demand recompense from E for the value of the work which F provided in the construction of E's house.

Causative purpose or expectation. The purpose or expectation must constitute the basis for the enrichment. In other words, it must be causative. An enrichment which the disadvantaged person would have conferred in any case, independent of the particular purpose not achieved or the expectation not fulfilled, does not come within the terms of the paragraph. In such circumstances it would be impolitic to regard the enrichment as unjustified because the disadvantaged person is in no need of protection unless the enrichment is predicated by the purpose or expectation (i.e. where it can be said that 'but for' the purpose or expectation the enrichment would not have been conferred).

Failure of negotiations. This paragraph is of particular relevance where, prior to the conclusion of contractual negotiations, an enrichment is conferred with a view to the benefits to which the disadvantaged person would be entitled under the anticipated contract. In such a case the disadvantaged person – not being contractually obliged to do so – may well have enriched the other party in order to induce the conclusion of a contract and thus obtain an enforceable right to some benefit in return.

(c) The enriched person's awareness of the purpose or expectation: sub-paragraph (b)

General. It is not a condition of the application of paragraph (4) that the purpose or expectation be a shared one (although that is, of course, one possible scenario). It is, however, a requirement that the enriched person was or ought to have been aware of the disadvantaged person's purpose or expectation at the time of conferring the enrichment. This limitation ensures that the ambit of the Article is confined to sensible proportions since the purpose or expectation must necessarily be either communicated to the enriched person or else, from an objective standpoint, easily identifiable in the circumstances. This limitation provides the safeguard that those who venture to advance their interests without either making this apparent or concluding a contractual agreement will do so at their own risk. This goes some way to creating an incentive to clarify legal relations before undertaking some measure which will enrich another.

Illustration 41

After their divorce and the sale of the matrimonial home the man moves into the flat occupied by his ex-spouse. An attempted reconciliation is unsuccessful. Subsequently the man demands recompense from his ex-wife for the sums which he spent at his own initiative discharging his ex-wife's debt with a mail-order business. Even if those payments were made in the precise expectation that there would be a long-term continuation of the relationship, an unjustified enrichment claim could only be conceivable if as a very minimum the ex-wife knew of the discharge of her debt. Only then could it be arguable (and a matter for proof) that she was at least capable of sharing her ex-husband's expectation in making the payment.

(d) The enriched person's acceptance that the enrichment must be reversed: sub-paragraph (c)

General. A final restriction contained within the Article is the requirement that the enriched person accepts or may be regarded as accepting that there must be a reversal of the enrichment if the purpose is not achieved or the expectation not fulfilled. That requirement is not satisfied if the disadvantaged person manifestly meant to take the risk of failure. The conferment of an enrichment by the disadvantaged person as part of what is patently a purely speculative enterprise is inconsistent with the notion that the enriched person has accepted an obligation to reverse the enrichment. Manifest speculation by the disadvantaged person implies rather that the enrichment may be accepted by the recipient on the basis it is “without strings attached”.

Illustration 42

D makes a living by cleaning cars in a car park, without obtaining the car owners’ permission in advance, and soliciting afterwards for remuneration when the owners return to their cars. E sees D cleaning her car and rightly supposes that D hopes to be paid, but does not intervene to stop D. Afterwards E drives off without paying D. The service which has been rendered is not an unjustified enrichment. Although D cleans the car only because he hopes to be paid for his service, D intends to take the risk that he will not be paid. E cannot be regarded as having accepted that D must be paid for his service.

Illustration 43

D is a professional locator of heirs. By following up published notices and various means of research he locates persons entitled to shares of deceased person’s estates which have not been claimed. Having found that E is entitled to a share in the estate of X, D contacts him, arranges a meeting at which he outlines E’s entitlement, and offers to disclose full details in exchange for a specified percentage of E’s interest. E considers D’s terms exorbitant and rejects the offer. From the information D has already disclosed, E is able to make his own inquiries so as to enforce successfully his claim to a share of X’s estate. D claims from E the value of the service he provided in disclosing information enabling E to assert his rights in respect of X’s estate. The claim is made on the basis that D conferred this enrichment only in order to obtain from E a contractual promise to reward him for full disclosure and that the enrichment is therefore unjustified under this article. D’s claim must fail. The enrichment is not unjustified. The requirements of paragraph (4) are not satisfied because D assumed the risk that, despite the information, E would not agree to his offer. E cannot be regarded as having accepted that he would have to pay for the information obtained during the negotiations. If the negotiations were terminated contrary to good faith, D might be entitled under II.–3:301 (Negotiations contrary to good faith and fair dealing) paragraph (3). The redress in that case, however, is not restitutionary, but rather compensatory as reparation for loss.

VII.–2:102: Performance of obligation to third person

Where the enriched person obtains the enrichment as a result of the disadvantaged person performing an obligation or a supposed obligation owed by the disadvantaged person to a third person, the enrichment is justified if:

- (a) the disadvantaged person performed freely; or***
- (b) the enrichment was merely the incidental result of performance of the obligation.***

COMMENTS

A. General

Overview. This Article creates an exception to the preceding Article and so narrows the range of enrichments which may be regarded as unjustified and giving rise to an enrichment claim under the basic rule. The exceptions are two in number. Firstly, an enrichment which is conferred by the disadvantaged person under an obligation to a third party is justified, but this exception applies only if there is free consent (to the performance) on the part of the disadvantaged person; paragraph (a). Secondly, an enrichment is also justified, even if there was no obligation to confer the benefit on the recipient, if such benefit is an incident of discharging an obligation to a third party: paragraph (b).

Relation to VII.–2:101 (Circumstances in which an enrichment is unjustified). This Article operates as an exception to VII.–2:101 (Circumstances in which an enrichment is unjustified) in that it provides a justification for enrichments which are otherwise unjustified. Accordingly, this Article has no relevance to enrichments which are already regarded as justified under VII.–2:101 (Circumstances in which an enrichment is unjustified). This excludes all enrichments which are justified under paragraph (1) of that Article (and not unjustified under paragraph (4) of that Article) because the enriched person was entitled to the benefit of the enrichment by virtue of a contract or other juridical act or, as the case may be, a rule of law or court order.

B. Performance under obligation to a third party: para. (a)

General. Paragraph (a) provides that a person who freely performs to the enriched person in compliance with an obligation owed to a third person confers a justified enrichment. The existence of an obligation to provide the enrichment precludes the disadvantaged person from claiming its reversal. That applies regardless of whether the obligation is valid or void (or avoided). This ensures that performances rendered under a contract normally give rise to liabilities only between the parties to that contract, even though a third party may have obtained a benefit as a result. It reflects the policy that reversal of unjustified enrichments resulting from a given ineffective juridical act is as a rule a matter only for those who concluded that juridical act. A party who has performed a contractual obligation must generally seek redress from the other party to the bargain – in contract law if the contract is valid and under enrichment law if it is not.

Illustration 1

X, a customer of bank D, instructs the bank to transfer funds to the credit of E, a football club of which X is the chairperson and to whom X is indebted. The bank makes a payment to the credit of E in accordance with X's instruction. D was mistaken at the time of transfer as to X's creditworthiness and would not have made the transfer if it had known the true situation as regards the state of X's financial arrangements. Nonetheless D has no enrichment claim against E. D's right to repayment of the money transferred is exclusively against X, to whom D was contractually obliged to effect the transfer. That D's contractual claim against X may be worthless if X is insolvent does not affect the matter.

Illustration 2

D is engaged by X, the vendor of computer equipment, to correct a defective installation of pre-installed software on a network of computers sold by X to E and operating in E's premises. After D has completed the work, but before any payment by X to D, X becomes subject to insolvency proceedings. D has no enrichment claim against E because any enrichment of E is the result of D's performance of a contractual obligation to X to perform to E. D is confined to a contractual claim against X, even if D's claim against X is virtually worthless. D took on this risk of insolvency when contracting with X.

Illustration 3

D contracts with X, a tenant of a building owned by E, to install a new heating system and carries out the work. E may have been enriched in so far as under the applicable property law the heating system may have become part of E's property. Even if the contract between D and X is void or avoided (so that D has no contractual claim against X for remuneration of the service provided), D still has no claim under enrichment law against E, assuming there is nothing like fraud, threats or unfair exploitation affecting the matter. Since E's enrichment results from D discharging an obligation to X, the enrichment is justified in relation to E, as a third party to the obligation, even though the obligation was of no effect. The enrichment is only unjustified in relation to X. D has an enrichment claim against X.

Illustration 4

T is a tenant of land let by L. The rent is relatively low, but T is obliged under the terms of the lease to renovate and convert a building on the land. T procures for this purpose from bank B a loan which T intends to finance by sub-letting the land to third parties. The loan is secured by a charge over the land granted by L. After the conversion of the building is finished, L resolves to sell the land. T is agreeable to the sale provided the loan is repaid out of the proceeds of sale. B releases the charge when L procures an alternative security, namely a guarantee from bank X. In breach of the agreement with T, L fails to pay off the loan. After unsuccessfully seeking re-payment from T, who has defaulted on the loan, B successfully sues X on the basis of the guarantee. Y (the assignee of X) has no claim under this Book against T, even though T is undoubtedly enriched by X's discharge of his debt to B (decrease in liabilities). However, X benefited T in the performance of an obligation which X owed to L, L having procured the guarantee of T's debt as a replacement security. Having paid B, X (and thus Y as successor to X's right) had a contractual claim against L on the terms of the agreement under which X undertook to L to enter into the guarantee of T's debt to B.

Performance of an obligation owed to a third party. While the obligation owed to the third party need not be valid, it is critical that what the disadvantaged person has done to benefit the enriched person lies within the four corners of the obligation. The immunity of a third party to a juridical act from an enrichment claim by the disadvantaged person depends on the enrichment being conferred in compliance with that obligation. An enrichment of another which is not covered by even a void or avoided obligation to a third party is not within the purview of this Article. An enrichment is therefore not justified under this Article merely because the disadvantaged person wrongly supposed there was an obligation to a third party to perform. A case in point here is where the performing party meant to discharge the obligation and tendered the performance with that in mind, but in fact did something which had nothing to do with the contract. A direct claim against the other party to the contract

would often be a nonsense: what has been done was not at the contractual partner's bidding. Where the enrichment conferred is not envisaged by the terms of the juridical act – for example, because it departs from them in some fundamental manner (such as conferring benefit on the wrong person) – the disadvantaged person may seek reversal of the enrichment directly from the recipient.

Illustration 5

X instructs bank, D, to make a payment to Y. As a result of carelessness for which D is solely responsible, D makes a corresponding payment to E instead of Y (though meaning to pay Y). D may reclaim under this Book the money paid to E by mistake. E has not been enriched by D's compliance with an obligation to a third party (X) because D was not required to pay E under the terms of the mandate.

Illustration 6

A debtor D granted a debiting facility to company C, a contractual creditor. Via its bank B1, C causes D's account at the bank B2 to be debited with certain sums. Because C's performance is sub-standard, D objects to the debit and, since the debit functions only on the basis of ratification, B2 is obliged to credit D's account, as B2 is obliged to do under the terms governing the debit facility. However, under the terms of the inter-bank framework agreement regulating the debit facility, B2 can no longer reclaim the sums from B1: although D objected to the debit within the time period allowed under its contract with B2, the debit was reversed after the expiry of the period provided for by the framework agreement. B2 has a direct claim under this Book against C. B2's transfer which benefited C was not made in performance of a contractual obligation to D since there was no authorisation for the transfer (D not ratifying the debit). The enrichment of C is not justified as against B2.

Rationale. This Article rests on the policy consideration that as a rule a party who incurs a (real or apparent) obligation to another must look for redress from the party to whom the obligation was owed (be it a right to counter-performance under a valid contract or a right to reversal of the enrichment of the apparent creditor). The rationale is that the parties to the contract have sought themselves out and, as regards any restitutionary claims arising out of the failure of their purported contractual agreement, ought to look only to their counterpart for recompense since in the usual case it was from that other party (and not any other person who may be directly or incidentally benefited) that the disadvantaged party expected its counter-performance. As a rule it would be impolitic to permit a party who has performed an obligation under a contract which is without effect to claim redress under the law of unjustified enrichment from someone other than the other party to the contract. To do so would provide the performing party with a windfall – a right not bargained for – and an opportunity to circumvent the risk of insolvency of the contractual counterparty which was willingly accepted when the bargain was concluded. Accordingly, where a party performs an obligation under a contract which is void or avoided, the claim in enrichment law must normally be made against the other party to the contract.

Exception. An exception to this fundamental principle is made only where the underlying juridical act (by virtue of which the third party to the transaction has benefited) is void (or avoided) and the disadvantaged person's obligation is vitiated by incapacity, fraud, threats, or unfair exploitation. In this case the assumption underpinning the primary rule that the performing party has sought out the contractual partner and accepted the risk of

disappointment is challenged because the consent to those risks has been extracted rather than entered into freely.

Illustration 7

D solemnly undertakes to X to pay €500 to E and subsequently performs the undertaking. The undertaking is void as a binding promise if D lacks contractual capacity. In that case D has an enrichment claim against E in respect of the payment. In view of D's lack of capacity, the enrichment is unjustified, notwithstanding that E is a third party to the juridical act.

Illustration 8

X, who has stolen E's car, brings it to D's garage. Supposing X to be the owner, D agrees to effect various necessary repairs at usual rates. After completing the repairs, but before the car is collected, the true situation emerges. X has absconded. D demands payment for the services from E. Although D was contractually bound to X to render the service, the contract is voidable for fraud and D avoids the contract. D may have an enrichment claim against E. Admittedly any enrichment of E results from D's performance of a contractual obligation to X, but as that obligation is (retrospectively) without effect and as the enrichment is obtained as a result of X's fraudulent misrepresentation, the exception applies and E's enrichment is not justified in relation to D.

No exception for error. A distinction of importance is that in contrast to the factors which prevent a disadvantaged person from freely consenting to a disadvantage or freely performing an obligation (incapacity, fraud, threats and unfair exploitation), error is only relevant in the context of consent to the disadvantage (i.e. for para. (1)(b) of VII.-2:101 (Circumstances in which an enrichment is unjustified)). If the performance of an obligation is based on an error (including an error which vitiates an underlying juridical act), the enrichment may nonetheless be justified. This restriction on the relevance of error is to be viewed as the reverse side of the significance of incapacity, fraud, threats and unfair exploitation. Those factors – unlike mistake – are regarded as so fundamental as to justify encroaching on the principle that reversal of enrichments in the context of a (void or avoided) contract should take place only between the parties to that contract and that enrichment liability is not to be imposed on third parties to that contract. In the case of fraud and other serious vitiating factors, a person who has benefited directly from the disadvantaged person's performance of an obligation to another is deprived of immunity from an enrichment claim in order that in suitable cases (i.e. where that third party has benefited gratuitously and is otherwise not deserving of protection) the disadvantaged party may proceed directly against the recipient of the benefit. This will be of particular importance in cases of fraud, where the deceiving contractual partner may have absconded and a claim to reversal of the enrichment solely in the contractual line is more or less worthless, while the end recipient is ascertainable and still in possession of a bounty.

Illustration 9

S has agreed to act as surety for M's debt with the bank B1. Under the contract of suretyship S authorises B1 to debit the debt, should it fall due, directly from S's account with bank B2. B1 acts on this debit authority. B2 pays B1, although the account of S is not sufficiently in credit to cover the sum debited; S is insolvent. B2 has no enrichment claim against B1. B2 has performed freely and rendered a contractual performance to S. While B2 may not have checked whether S's account was sufficiently in credit and would not have paid B1 had it known the state of S's

account, this is merely a matter of error and does not affect the fact that B2 performed freely.

Third parties with a right to performance. A difficult question arises where there is a contract for the benefit of a third party by virtue of which the third party is entitled (under Book II, Chapter 9, Section 3 (Effect of stipulation in favour of third party) to compel performance of an obligation under the contract for the benefit of the third party. Is the third party in such circumstances to be regarded as a party to the obligation? An affirmative answer has the effect that the enrichment is potentially unjustified in relation to the third party, from whom the performing party may then be able to demand a reversal of the enrichment. A negative answer will as a rule immunise the third party from a direct enrichment claim of the performing party, who must look for recourse from the other party. Since the third party can demand performance it seems natural to regard that party as a party to the obligation and fitting that the third party should take the burden associated with the benefit – i.e. a liability to give back (directly to the performing party) the enrichment which the third party had a right to demand (directly from the performing party). If that is the outcome, the other party to the obligation and the third party must be regarded as solidarily liable for the reversal of the enrichment. However, the better view must be that a mere right to demand performance cannot in itself render a person a party to the obligation (which category extends to assignees). Such rights are subject to the defences which the performing party may have vis-à-vis the other party to the obligation (see II.–9:302 (Rights, remedies and defences) paragraph (b)), so that the mere holder of a right to a performance is not a party to the obligation in a complete sense. Pointing in favour of the latter view, by contrast, is the apparent illogic that the purpose of conferring on a third party a right to performance is to enhance the position of the third party and to regard the third party as a party to the obligation would have the seemingly curious result that the third party is burdened with a liability under unjustified enrichment law which would not otherwise have existed. In other words, the third party is ‘better off’ if a mere beneficiary without any colour of right to a performance. Moreover, the other party to the obligation may have a defence to an enrichment claim of the performing party and that defence could be circumvented if the performing party is able to sue the third party directly for a reversal of the enrichment.

Assignees and other creditors. The same principle applies in cases where performance is rendered to an assignee or where the performing party is instructed to perform directly to a creditor of the other party to the contract. The situation is otherwise only where the assignee is not a mere assignee but a person who has taken over obligations as well as rights of a party to the transaction. A party who is substituted may be a party to the obligation where an assignee alone would not be.

Illustration 10

D concludes with X a contract for the purchase of a quantity of paper which is to be imported by X from a manufacturer, Y. According to Y’s specifications, which X has passed on to D, the paper is suitable for use in printing. After the contract is concluded, X’s right to payment of the purchase price by D is assigned to E and D is given notice of the assignment. D pays the purchase price to E. It is later discovered that contrary to the mutual assumption of D and X the paper is of an inferior grade and cannot be used for printing. D avoids the contract on grounds of mutual mistake. D has no claim against E under the law of unjustified enrichment for repayment of the price. E’s enrichment is justified because it resulted from D’s performance under D’s

contract with X. It is immaterial in this case that the contract was without effect. D's unjustified enrichment claim is against X.

Illustration 11

E contracts to purchase a quantity of sugar from X, who covers that contract with an option for X to buy sugar from D. X exercises the option and orders D to deliver directly to E. D makes the delivery to E. Even if D's contract with X is without effect D has no unjustified enrichment claim against E. E's enrichment is justified under this Article because it is obtained as a result of D's performance of a contractual obligation with X, and E is a third party to that contract. D has only a claim against X.

Further applications. The principle may apply even where the disadvantaged person has unwittingly performed an obligation owed to a third party because statutory rules (such as rules for the protection of a debtor acting in good faith) enable a performance which would otherwise normally not constitute a performance to discharge the obligation nonetheless in special circumstances.

Illustration 12

D, a debtor, pays the creditor, E. Unknown to D, E had earlier assigned the right against D to the assignee X. E (having assigned the right) was not entitled to the enrichment from D. D was mistaken in assuming the existence of an obligation to pay E, when it was in fact X who was entitled to payment. However, D cannot demand a repayment from E. Although D has not paid the creditor (X), D is nonetheless discharged from the obligation: see III.-5:118 (Performance to person who is not the creditor) paragraph (1). D has discharged the obligation to the new creditor (the assignee X) in performing to the former creditor (assignor E). E's enrichment is justified under this Article in relation to D. E's liability is to X.

C. Incidental benefit to enriched person from performance to a third party: para. (b)

General. Paragraph (b) provides that a person who incidentally enriches another while freely performing an obligation owed to a third person confers a justified enrichment on the person incidentally enriched. As in the case of paragraph (a), this applies regardless of whether the obligation is valid or void (or avoided). These two provisions may be regarded as a composite, protecting the third party from an enrichment claim in most cases where a legal relationship (especially a contractual one) between the disadvantaged person and a third party was the essential reason for the enriched person being enriched. The notional boundary between the two provisions lies in the fact that whereas paragraph (a) is essentially concerned with the case where the object of the performance is to benefit the enriched person (as a third party to the juridical act), paragraph (b) comes into play where the enrichment of the third party to the juridical act was not the object of the performance, merely an (incidental) outcome. The rationale for this rule is essentially the same as that set out in B0.

Illustration 13

As a result of E's negligence, X's car is damaged. While the car is being repaired, X hires a car from D. It is agreed that payment of hire charges will not be due until X takes action against E to recover compensation. However, under the applicable national consumer credit legislation, the agreement to postpone payment of the hire charges constitutes a provision of consumer credit and the hire contract is

unenforceable for want of compliance with prescribed formalities. Consequently X is able to make use of the car without any contractual or enrichment liability to D to provide recompense. As a result of X being able to use the car hired from D without having to pay for that use, X's consequential loss arising from the damage to the car under repair is mitigated. It is assumed that this correspondingly reduces the sum of compensation due from E to X in respect of the negligent causation of the damage. E is therefore enriched by a decrease in liabilities. D has ultimately conferred a benefit on E. However, E's enrichment is justified in relation to D: E obtained the enrichment as a result of D's discharge of a valid (though unenforceable) obligation to X.

Illustration 14

X, the owner of a disused workshop, commissions D to clear it out and prepare it for a change of use. As a result of an error (for which X is responsible) contained in the fax sent to D, X provides D with the wrong unit number and D clears out and prepares disused premises owned by E. E was not entitled to this enrichment – either against D or against X. However, D's contract with X is valid as a contract to refurbish the premises referred to in the fax (see inter alia II.–7:201 (Mistake)) and D was therefore obliged to X to provide this benefit. D's enrichment of E is justified; it results from D's discharge of an obligation owed to X. Consequently D has a contractual claim against X, but no enrichment law claim against E. Any enrichment liability of E will be to X: X did not consent to the disadvantage (incurring a contractual debt to D) without error, because X was mistaken as to the details of the performance due under the agreement.

VII.–2:103: Consenting or performing freely

(1) If the disadvantaged person's consent is affected by incapacity, fraud, coercion, threats or unfair exploitation, the disadvantaged person does not consent freely.

(2) If the obligation which is performed is ineffective because of incapacity, fraud, coercion, threats or unfair exploitation, the disadvantaged person does not perform freely.

COMMENTS

A. Absence of free consent: incapacity, fraud, threats and unfair exploitation

General. This Article provides that a person does not consent to a disadvantage or perform an obligation freely if the consent or obligation is affected by incapacity, fraud, coercion, threats or unfair exploitation. Where the consent or performance is so affected, the justifying grounds in the previous Articles which depend on free consent or a freely given performance do not apply.

Overlapping grounds for absence of free consent. In given circumstances there may be several reasons why the disadvantaged person cannot be said to have consented freely to their disadvantage. Nothing turns on this. If any one of incapacity, fraud, coercion, threats or unfair exploitation is made out, the enrichment will not be justified on the basis of free consent.

Meaning of fraud, coercion, threat and unfair exploitation. The notions of fraud, coercion, threats and unfair exploitation invoked in II.–7:205 (Fraud) to II.–7:207 (Unfair

exploitation) (the latter referring to taking grossly unfair advantage or excessive benefit)) will be material here. However, they are not directly applicable since those provisions are formally concerned only with rights to avoid contracts. Moreover, those terms themselves are not explicitly defined in the Book II; a particular meaning of the concepts may be derived implicitly from those provisions and that meaning must then be transposed to situations where there is no contract at all. So, for example, fraud will occur where the disadvantaged person is led to confer the enrichment by another's representation (or non-disclosure of information which good faith and fair dealing required be disclosed) which was made with knowledge or belief that it was false and was intended to induce the disadvantaged person to make a mistake (cf. II.–7:205 (Fraud) paragraph (1), (2)). A threat must be of imminent and serious harm. A consent or performance will be affected by unfair exploitation if the enrichment is obtained as a result of a person exploiting the disadvantaged person's situation of distress or vulnerability.

Source of the fraud, threat or unfair exploitation. A second consideration is that those provisions of Book II are focused on demarcating the circumstances in which the vitiating factors of fraud, coercion, threats, and unfair exploitation are material as regards the validity of the contract. As in the case of mistake, those restrictions are not to be regarded as carried over to this Book, where the concern is not with determining the binding character of a promise, but rather the restitutionary effect of a prestation conferred. Here, for example, it suffices generally that someone has induced the enrichment by fraud, irrespective of whether that was the enriched person or third person. (This is in contrast to the restrictions of II.–7:208 (Third persons), where, if the contractual partner has already acted on the contract, a right to avoid the contract based on the fraud or threats of a third person is made out only if the contractual partner is responsible for the third person's acts or assented to that person's involvement in the contract formation or knew or ought to have known of the relevant facts.) Thus this paragraph applies where the consent or performance is affected by fraud, coercion, threats or unfair exploitation affecting the disadvantaged person regardless of the source of the abuse constituting the vitiating factor. The person perpetrating the fraud, coercion, threat or unfair exploitation need not be the enriched person. Nor need the defect in the disadvantaged person's consent to the transaction have been induced by a third party acting on behalf of the enriched person. The source of the fraud, threat or unfair exploitation may be a person unconnected with the enriched recipient of the benefit.

Rationale. The choice of more liberal rules here is deliberate. The Article applies to cases where there is no contract or other juridical act involved at all. In that case there is no a priori reason why the provisions in Book II should demarcate the outer boundaries of a right to reclaim an enrichment. Given that the existence of an obligation to confer an enrichment constitutes a justification for that enrichment (except for cases within paragraph (4) of VII.–2:101 (Circumstances in which an enrichment is unjustified)) there is every reason to read the concepts in this paragraph in wide terms.

Illustration 1

E, pretending to be X, asks D, a debtor of X, to pay an outstanding debt which is repayable on demand. D pays to E in compliance with that demand to discharge the debt. It is assumed that although D is a victim of E's fraudulent impersonation, D is not protected and the debt to X is not discharged. Consequently X retains the right against D. E is enriched by D's payment. That enrichment is unjustified under the terms of this Article since it was obtained as a result of a fraud practised on D, is not obtained as a result of D's free consent to the disadvantage and accordingly is not justified under paragraph (1) of this Article. D has an enrichment claim against E.

CHAPTER 3: ENRICHMENT AND DISADVANTAGE

VII.–3:101: Enrichment

(1) A person is enriched by:

- (a) an increase in assets or a decrease in liabilities;*
- (b) receiving a service or having work done; or*
- (c) use of another's assets.*

(2) In determining whether and to what extent a person obtains an enrichment, no regard is to be had to any disadvantage which that person sustains in exchange for or after the enrichment.

COMMENTS

See Comments to following Article.

VII.–3:102: Disadvantage

(1) A person is disadvantaged by:

- (a) a decrease in assets or an increase in liabilities;*
- (b) rendering a service or doing work; or*
- (c) another's use of that person's assets.*

(2) In determining whether and to what extent a person sustains a disadvantage, no regard is to be had to any enrichment which that person obtains in exchange for or after the disadvantage.

COMMENTS

A. General

Twin provisions. VII.–3:101 (Enrichment) and its mirror-image twin VII.–3:102 (Disadvantage) address the second and third elements essential to establishing an unjustified enrichment claim: namely, the existence of the other party's enrichment and a disadvantage on the part of the claimant. While the claimant's disadvantage and the enriched person's enrichment need not be of the same type, the types of benefit or detriment which may constitute an enrichment or disadvantage are fundamentally the same, as is reflected in the corresponding wording of the two rules. Moreover, in simple cases, where the enrichment is furnished directly by or obtained directly from the disadvantaged party, the claimant's disadvantage and the enriched person's enrichment are simply different sides of the same coin. For that reason these two Articles may be considered together, taking VII.–3:101 (Enrichment) as the focus of these comments.

Overview. Paragraph (1) of each Article sets out a definition based on an exhaustive enumeration: VII.–3:101 (Enrichment) lists the types of benefit which are recognised as constituting enrichments relevant to the application of the basic rule and VII.–3:102

(Disadvantage) does the same for the notion of disadvantage. Moreover, each Article also sets out (in paragraph (2)) the principle that enrichments and correspondingly disadvantages are, as it were, the individual positive (or, as the case may be, negative) items on a balance sheet; enrichment or disadvantage is not the “bottom line” figure representing the balance itself (i.e. the aggregate of all positive and negative entries).

Relation to Chapter 4 (Attribution). In applying these Articles, account must be taken of the rules in Chapter 4 (Attribution). While this Chapter defines what constitutes an enrichment and a disadvantage, those rules impact upon the question as to who is enriched and who has suffered a disadvantage since in given circumstances they may have the effect, for example, of shifting an enrichment or a disadvantage from one person to another (see VII.–4:102 (Indirect representation)).

Relation to other Chapters. These Articles are concerned solely with the issue of whether or not a given person is enriched or disadvantaged. If a person is not enriched within the meaning of VII.–3:101, then that person cannot be obliged under this Book: there is no liability because there is simply no enrichment to reverse. Equally, if the claimant has sustained no disadvantage within the meaning of VII.–3:102, any enrichment of another has not been at the claimant’s expense and there is no entitlement under this Book. The existence of both an enrichment of another and a disadvantage of the claimant, however, does not dictate that the enriched person is liable under this Book. That is so even if Chapter 2 establishes that the enrichment is unjustified. It must be established in addition, in accordance with Chapter 4, that the enriched person’s enrichment is attributable to the claimant’s disadvantage. Furthermore, the rules in Chapters 5 and 6 must be applied in order to ascertain what quantum of liability, if any, arises.

B. Increase in assets or decrease in liabilities: paragraph (1)(a) of VII.–3:101

Change in assets or liabilities, not change in value. Paragraph (1)(a) of VII.–3:101 (Enrichment) provides that a person is enriched by “an increase in assets or a decrease in liabilities”. In essence, any beneficial adjustment to either the positive or negative sides of the patrimonial balance sheet – the arrival of a new positive entry or the removal of a negative entry – constitutes an enrichment. However, the definition only embraces a change in substance. It does not extend to a mere change in the value of assets (which are themselves unchanged). There must be an increase or decrease in the quantum of subject-matter not a mere re-appraisal in how the market appreciates an otherwise unaffected quantum. Some new asset must enter or some old liability must leave the patrimony. On the other hand, benefits which do not involve a change in assets or liabilities may nonetheless amount to an enrichment under the other paragraphs of this article – in particular where a service is rendered or work is done.

Illustration 1

D, the owner of a field which abuts a garden attached to E’s house, has been lawfully using the field to store scrap material. The pile of junk is a substantial eye-sore and E has found it difficult to find a buyer for the house and garden at an acceptable price. Following a change in business plans, D clears the field for more sightly commercial use and E is subsequently able to sell the house. Evidence from valuers indicates that the improved outlook from E’s garden added some € 4.000 to the purchase price. E is not enriched under this paragraph. E has not obtained any asset. The benefit was

merely an increase (before sale) in the value of existing property rights. (Nor has D rendered a service or done work for E: see C0.)

Meaning of asset. “Assets” are defined in Annex 1 as anything of economic value, including property, rights having a monetary value, monopolies and goodwill.

Criteria. An unstated criterion for present purposes is that an asset must in some manner be recognised as “belonging” to one party, for it is this which generates the sense that one person’s gain of that asset is at the expense of another. This implies that an asset must be an item, whether tangible or intangible, to which an element of protected exclusivity attaches. Secondly, it must be something which is capable of commercial exploitation. That is to say, it must be something for whose grant or use a person would be prepared to pay; it must be a right or an equivalent which is of potential economic benefit. ‘Asset’ is thus an umbrella term for all such forms of economically valuable positions which are legally protected.

Examples. The term certainly includes money and property rights including intellectual property rights and any other form of right, such as a contractual right e.g. a receivable (i.e. ‘book money’), a right to compensation for damage, a right to benefit under a trust, and even a right under the law of unjustified enrichment itself. It will not matter whether the property concerned is tangible or intangible, moveable or immovable, and the distinction between proprietary, quasi-proprietary and pure personal rights is equally irrelevant here. It is likewise immaterial whether the right is characterised as essentially procedural or ancillary to some other right: the goodwill of a business or a right to correction of a register of title, for example, may constitute an asset. Moreover, confidential and valuable information may also constitute an asset in so far as its “owner” is entitled to restrict its use or circulation. An example in this category would be an outline for an invention or device which is not yet patented and therefore only an inchoate intellectual property right. A compelling factor is thus whether the “owner” of the “asset” is entitled to prevent infringements or adverse interference.

Illustration 2

D makes a payment by bank transfer. Because D makes a mistake, payment is made to E’s account, which is in credit. E is enriched under this paragraph by receipt of the funds. E’s personal right as account holder and creditor of the bank is enlarged to the extent of the increase in the balance (which is the sum E can demand be paid out by the bank).

Illustration 3

E acquires at an auction a car belonging to the estate of a famous person and with a personalised number plate bearing his initials (‘TAC 1’). The auctioneers neglect to hold back the personalised number plate, which was not part of the sale, but which as a result of the failure to reserve a right of retention under the statutory scheme governing personalised number plates passes to E with the change in title to the car. E is enriched by acquiring the right to use and retain the personalised number plate, an asset which has a market value of some £15,000.

Mode of increase in assets. Provided that a given acquisition constitutes an increase in assets, it will be immaterial for the purposes of this article how that acquisition has come about. An acquisition of property, for example, will be an increase in assets amounting to an enrichment whether this is an acquisition of title by transfer (sale, assignment, etc) or by any

other means (e.g. accession). However, this does not prevent the mode of increase in assets being relevant in other contexts, such as whether or not the enrichment is justified, whether it is attributable to a disadvantage, and what is the measure of any liability of the enriched person. In that context the lawfulness of an acquisition will be especially material.

Illustration 4

D constructs a building on E's land. E is enriched under this paragraph. E has obtained an increase in assets: the building has become part of E's immoveable property by accretion to the land. It is immaterial, for the purposes of this Article, whether D requested the building and whether C knew the land belonged to E; such matters are relevant under other articles of this Book.

Decrease in liabilities. Paragraph (1)(a) also provides for enrichment in the form of a reduction in liabilities. The typical instance will be where a debt which a person owes is fully or partially discharged. This increases the net balance of that person's patrimonial wealth and therefore merits treatment as an enrichment quite as much as a positive gain. It can hardly be material whether the recipient's bank account is in credit and merely enhanced (increase in assets) or overdrawn and the debt fully or partly cleared (decrease in liabilities). The notion of liabilities extends beyond contractual debts and thus includes, for example, non-contractual obligations or other obligations under private law. Nor is there any requirement that the creditor has in fact demanded performance of the obligation: the bare existence of a liability and its reduction suffices. On the other hand, there will be no decrease in liabilities if the supposed liability is entirely spurious: there must be a legal obligation to perform (e.g. to compensate or provide recompense). The same applies correspondingly where a legal liability has been waived by the creditor beforehand.

Illustration 5

A small amount of oil from X's oil tank flows into the soil of neighbouring premises belonging to N. The local authority undertakes the remedial action which in its view is necessary to deal with the pollution. Quite aside from VII.-7:103 (Public law claims) (according to which this Book need not necessarily apply to enrichments conferred in the exercise of public law functions), the local authority has no claim against X under this Book. If X were liable to N to make reparation for the damage caused, then the local authority's measures – in providing reparation in specie – would admittedly have reduced that liability. However, if under the applicable law a non-contractual liability in the circumstances presupposes that X caused the damage intentionally or negligently (i.e. there is no strict liability) and no negligence on X's part can be established, the liability of X which has been decreased by the claimant is non-existent. In such circumstances X has not been enriched.

C. Receipt of a service or having work done: paragraph (1)(b) of VII.-3:101

General; rationale. Paragraph (1)(b) of VII.-3:101 caters for an alternative form of benefit within the definition of enrichment in the form of the receipt of a service or having work done. The rationale for treating the receipt of a service as an enrichment is that whenever the market recognises a certain type of performance as valuable, the provider of that performance has necessarily rendered something valuable to the recipient and a transfer of value has taken place. Of course, where the service is unsolicited, the recipient may not feel 'better off' as a result. Such considerations (which may reduce or exclude liability on the part of the unwitting recipient) are taken up in later rules – in particular VII.-5:102 (Non-transferable enrichment).

Change in patrimonial balance immaterial. A service or work may (but need not) also result in a change to the balance of the enriched party's patrimony. A service which takes the form of 'pure consumption' or enjoyment is nonetheless an enrichment. A construction service (which adds a new structure to property), a treatment service (which merely improves the condition of existing property) and a transportation service (which merely relocates the person or property) are all services in the sense of this paragraph.

Composite notion of service or work. The concept of 'service' is an appreciably difficult one with rather vague boundaries. Its uncertain definition raises the prospect that taken by itself it might be too narrow in scope in bringing in certain benefits within the notion of enrichment. This is the reason for the extension of the paragraph to include "having work done", which is intended to embrace benefits similar in nature to services. The notion of 'service or work' may best be regarded as a composite intended to capture a particular range of intangible benefits.

Notion of service. The service concept normally assumes meaning in the context of contractual (or at any rate commercial) activity. A contract for the supply of services, for example, is in large part defined by contradistinction to an employment contract on the one hand and other specific contracts, such as a contract for the sale of goods, on the other. The notion of services put forward in the provisions specific to contracts for services (IV.C.-1:101 (Supply of a service) paragraph (1) This Part of Book IV applies (a) to contracts under which one party, the service provider, undertakes to supply a service to the other party, the client, in exchange for remuneration") leaves the core element of "services" entirely undefined and points only to particular forms of services (paragraph (2) refers to construction, processing, storage, design, information or advice, and treatment, and see also IV.C.-1:102 (Exclusions) referring to transport, insurance, guarantee and the supply of a financial product or a financial service). It may be taken that a service is an act or omission of a type normally undertaken for remuneration (cf. EC Treaty Art. 50(1)).

Services by agreement, but without a binding contract. In a contractual context one may assume that a service is undertaken in order to render benefit to a recipient. The difficulty in the present context, of course, is that there may not be a contractual relationship between the parties to the enrichment claim. This is not problematic where both parties have proceeded (mistakenly) on the footing that their relationship is one of contract, for it will be their view of the economic activity undertaken which would clearly characterise it as a service; the actual existence of a contract cannot be essential to the provision of a service if both parties regard the performance as a service. There is at least in that case an agreement for services and the identity of the service can be ascertained.

Illustration 6

D, a lawyer, undertakes to act for E in pursuing a claim against a third party on a conditional fee basis, D to be paid a fixed share of E's compensation if and only if E's litigation is successful. After E's claim succeeds and settlement is made by the third party, E disputes D's entitlement to the agreed share of the compensation. Although neither party appreciated this, the agreement between D and E was prohibited by the relevant national law applicable in this particular case. There was no valid contract for services: II.-7:302 (Contracts infringing mandatory rules). (It is assumed that national law provides the agreement is void as a contract.) Under the law of unjustified enrichment, D has rendered a service to E in conducting the litigation and E is

accordingly enriched in the sense of this paragraph. Whether the illegality of the transaction also affects liability under this Book is determined by VII.–6:103 (Illegality).

Unsolicited services. Enrichment by receipt of a service extends beyond ‘remunerative work agreed upon by the parties’ to cases where the service provider alone intends to provide a service on the basis of an assumption that this fulfils a request for a service or where there has been a genuine request, but it has not come from the party to whom the service is provided. Thus whether the mistake of the parties is bilateral or unilateral does not affect the qualification of work done as a service.

Illustration 7

Guest X at a hotel, operated by D, gives an instruction for some clothes to be cleaned and pressed during the day, while he is out of his room. The staff in the hotel make a mistake and take away similar clothes from the room of guest E, which are then returned cleaned and pressed. E is enriched under this paragraph. Of course, the fact that E is so enriched is not by itself determinative of whether E is liable to pay the value of that service (or any lesser sum) in order to reverse the enrichment.

Services provided unwittingly. A converse case is where the enriched person alone wishes to have the benefit of a service. In other words, the disadvantaged person provides a benefit to another unwittingly. If the service provider customarily provides the service to others on a fee-paying basis, it will usually be clear that the provider would have acted differently (for example, by acting so as to exclude benefit to the recipient) if aware of the true circumstances. Where the recipient has sought out the benefit in such circumstances, it will be just to regard that benefit as a service and an enrichment within this paragraph.

Illustration 8

E, a stowaway passenger on an aeroplane being flown by the D airline, flies from Hamburg to Munich. E is enriched within this paragraph. The benefit conferred (namely a flight from Hamburg to Munich) is a benefit of a type normally only provided to passengers in exchange for remuneration. It is immaterial whether E has made any saving of expenditure. For example, even if E would not have flown at all, had it not been possible to fly for free (because E merely took an opportunist advantage of lax security for the sheer thrill of the ride) E is still enriched under this paragraph. Although E in such a case has saved nothing, E is enriched by receipt of a service.

Incidental benefits in pursuit of own interest. Where there is neither an appreciation that benefit is being conferred on the part of the provider nor an active involvement on the part of the recipient in bringing about the benefit, its provision will not amount to the receipt of a service or work within the meaning of this paragraph. An exploitation of a state of affairs ‘after the fact’ is not a receipt of a service.

Illustration 9

A stream runs through land belonging to farmer D and, further downstream, land belonging to farmer E. In order to make better use of the water supply, D erects a filter which has the effect of cleansing the stream of debris. This improves the water supply for E as well as for D. D has nonetheless not enriched E within the meaning of paragraph (1)(b).

Illustration 10

D and E own neighbouring properties in a remote rural area. D enters into a contract with the X cable company for the installation of cable communications. This involves the company in building a cable ‘backbone’ spur from the highway across country to D’s property. Subsequently E engages X to lay cable to E’s own property. Since the X company (which owns the cable) is able to connect E to the freshly laid spur, E’s costs of connection are considerably lower than D’s. In obtaining a connection, E has taken advantage of the work which D had commissioned X to undertake. D has nonetheless not enriched E within the meaning of paragraph (1)(b).

D. Use of another’s assets: paragraph (1)(c) of VII.–3:101

General; meaning of “asset”. Paragraph (1)(c) of VII.–3:101 (Enrichment) caters for a third type of benefit within the definition of enrichment in the form of the use of another’s asset. The term “asset” in this paragraph bears the same meaning as in paragraph (a) (as to which, see B0-B0). In determining who, if anyone, is enriched under this heading (and correspondingly who, if anyone, is disadvantaged under the corresponding paragraph (1)(c) in VII.–3:102), it will be important to identify whose asset is being used.

Illustration 11

Company D constructs a waste water channel running from its property. Under statutory rules the channel becomes State property. Subsequently E makes use of the channel under the terms of a statutory regime. Although E profits as a matter of fact from the fruits of D’s expenditure, D has no claim under this Book against E. E has not made use of D’s assets. Rather E has made use of State property. Nor will D have a claim against the State if the State’s enrichment is justified because the State is entitled by law to the benefit of its enrichment (the increase in assets as a result of acquiring the channel) – i.e. if the regime governing the expropriation provides its own mechanism for compensating D.

Assets capable of use. The paragraph necessarily applies only to those assets which are capable of use. In principle this encompasses all transferable absolute rights, such as property rights including rights to intellectual property. However, the right need not be capable of transfer and it will suffice that the right is one which another person might be licensed to use. This will therefore embrace relative rights and non-transferable absolute rights, such as contractual rights and rights of personality. Use of another’s asset will likewise cover one person’s exploitation of another’s confidential information or an invention or design which might be, but has not yet been, converted into a fully-fledged intellectual property right. Conversely, there will be no use of an asset within the meaning of this paragraph if public policy considerations preclude even a notional commercialisation of use.

Illustration 12

E occupies a caravan, which D rents from X. E is enriched in using D’s asset, namely the right of D vis-à-vis X to occupy the caravan. It is immaterial whether or not D’s contract with X prohibits or permits D to transfer this right or whether the right of D amounts to a proprietary right of possession.

Illustration 13

An inventor, D, enters into negotiations with a manufacturer, E, with a view to the possible exploitation of D’s patent for a carpet grip. In the course of negotiations D

outlines a new alternative design for an improved carpet grip. After the negotiations fail, E commences production of carpet grips based on the design outlined (but not patented) by D. D has a claim under this Book. E has made use of an asset of D and that enrichment was unjustified. D's alternative design, while not an intellectual property right in the sense of the patent, was nonetheless protected in law in so far as D was entitled to prevent use of the information disclosed in confidence to E. That right to control exploitation of the information was an asset of D's.

Irrelevance of authority of right-holder to license use. While a right must be susceptible of commercial exploitation in order to constitute an asset (see B0), there is no requirement that the holder of the right which the enriched person has exploited must personally be in a position to authorise another to use it. The de facto use of a right which de jure the enriched person could not be authorised to use is nonetheless a use of an asset within the meaning of this paragraph. The right-holder need not have the power to assign or sub-license the exercise of the right, but it is essential that the right must be of a sort which, were it not restricted by the terms of its grant to the right-holder or by the limited capacity of the right-holder, could be made the subject-matter of contractual licence in exchange for some valuable benefit. In this way the requirement of potential commercialisation relates to the intrinsic nature of the right and not, as such, to whether the right-holder has a power of or capacity to assign it or permit another's use. Where the holder cannot transfer or license another to use an asset, the requirement of commercial exploitability is fulfilled, for example, if the right was valuable in grant (i.e. a grantor could have demanded value for it and a grantee would have been willing to pay for the grant). Of course it may well be that a personal right will not have been granted for value, but it is the notional possibility of a purchase price which matters, rather than whether or not the right-holder actually did have to pay for the grant of the right. A right may be valuable, even though it is granted gratuitously.

Illustration 14

X is the owner of a small cottage, inherited from his father, which X has hitherto only used as a holiday home. As X would like to provide D, an elderly gentleman who during his long working life had given loyal service to his father as his gardener, with a retirement home, it is formally and irrevocably agreed that D can occupy the cottage for the rest of his life. After a long spell in hospital, D returns to find E is in occupation of the cottage. E is enriching herself within the terms of paragraph (1)(c) in using D's right to occupy the cottage for life. That D acquired this right gratuitously from X is immaterial because a notional owner of the cottage could have demanded and a notional occupier for life would have been prepared to pay a reasonable price for the grant of the right.

Irrelevance of right-holder's intention to use or commercialise use. Since the question of enrichment by making use of another's assets turns only on the intrinsic potential for commercialisation, the presence or absence of any concrete desire of the right-holder to commercialise the possible use of the right is not material in determining that a person who has used the right is enriched. The home dweller who is prevented from using the property by squatters rarely intends to licence the unwelcome occupants, but that does not affect the point that the squatters have enriched themselves by rent-free occupation of another's property. Equally it is immaterial whether the right-holder would personally have used the asset.

Illustration 15

In the preceding example, E is enriched by occupying the cottage while D was in hospital, regardless of (a) whether D needed the cottage for his own use and (b) whether D had any intention of giving up possession in exchange for payment.

Likewise, where a person has published pornographic pictures without the consent of an individual featured in them, that person has exercised a valuable right which the individual was able to license, even though a licence to that end might well be the very last thing the individual would have desired. In each case it is immaterial that the victim would never have dreamed of permitting the act done: the 'transfer of value' has taken place (against the victim's will) and an enrichment claim may simply make the best of an unwanted state of affairs.

Irrelevance of utility to enriched person. The use of an asset is an enrichment independent of whether this has produced any specific monetary gain or saving for the enriched person. Such matters may be relevant in the context of VII.-5:102 (Non-transferable enrichment), in determining the extent of the enriched person's liability if the enriched person is in good faith. Conversely, if the enrichment is in bad faith, the market value of a right to use (and not the actual benefit extracted from it) will provide a benchmark for the quantum of liability. In the case of publication of pornographic pictures of certain individuals, for example, the victims are entitled to claim a licence fee from the publisher even if publication to interested voyeurs is gratuitous.

Meaning of use. A use of an asset imports as a minimum an exercise of another's right or exploitation of the asset of that other. That in turn presupposes an intention to do the act which amounts to the utilisation of the asset. The requirement that another's asset be used also contains a further inherent qualification. It involves the limitation that the enriched party has in effect displaced another's (potential) enjoyment. Only then is a right or other asset belonging to another actually exercised rather than simply imitated. A further requirement contained within the notion of use of another's asset for the purposes of unjustified enrichment law is that the exercise of the right or exploitation of the asset must be of such a form that use is made of the asset: the act of interference with another's asset must be directed towards extracting utility from the subject-matter.

An intentional act. The requirement of an intention to do the act amounting to use of the asset does not mean, however, that there must be a deliberate will to displace the entitled party's enjoyment and avail oneself of something one positively knows belongs to another. The requirements of intention in the sense of Book VI (Non-contractual liability for damage) - where (leaving aside the case of foresight of an almost certain outcome) an intention to cause the damage is required (see VI.-3:101 (Intention) paragraph (a)) - do not govern here. Such notions of fault are not material to this Book. Persons who occupy land under the misapprehension it is their own or that it is ownerless exercise the rights of the landowner or other person entitled to possession and so make use of another's asset simply because (i) they occupy with an intention to occupy that land and (ii) that land (as it happens) is not available for their use.

Displacement of another's use. Displacement of another's use may be either complete or partial, both spatially and temporally. Thus the exercise of another's right for a time is as much a use of that asset as its exhaustive or extinctive exercise. Where the right exercised is

one of physical use, as in occupation of premises or possession of a thing, the use will generally be self-evident since such control of the thing generally displaces the corresponding use of another. Use of an asset will be no less present when the physical use is limited and displacement correspondingly partial, as in the case where a person in effect creates a right of way over another's land. Use by the owner is displaced to this extent, even though the owner's possession of the land is only marginally disturbed overall. Correspondingly, however, this is not a use of the whole asset which is at the owner's disposal, but rather a use of a component right – the right to give permission to cross the land. There is likewise a use of another's property where possession is shared.

Illustration 16

Every Saturday a market trader, E, parks a van on the forecourt of the premises owned by business D (which does not operate at weekends). E has made use of D's asset and is enriched within the meaning of this paragraph. It is immaterial that E's use does not interfere with D's actual use of the forecourt. To the extent of E's use, D's possible use of the space occupied by the van is displaced.

Illustration 17

E becomes acquainted with D, who represents herself to be a woman in financial and social need following a series of misfortunes. E agrees to let D occupy a room in his home rent-free and to have the shared use of other domestic facilities. E subsequently discovers that D is an habitual fraudster who preys on naïve young men like himself. D has enriched herself not merely in respect of the exclusive occupation of the room in which she lodges, but also in respect of her shared use of the other amenities in the dwelling.

This principle applies in a similar manner even when the property right exercised is intangible. A marginal encroachment may amount to a use of an asset.

Illustration 18

Without permission to do so, E reproduces a text whose copyright is vested in D. E is enriched within the meaning of paragraph (1)(c): E has made use of D's copyright. Although E's act did not preclude D from making or permitting copies at the same time, E has nevertheless made use of D's copyright because E's act necessarily prevented D's effective decision, at the point in time of reproduction, whether that copy should be made or not.

The situation is otherwise where the infringement is apparent only and the rights of the supposedly disadvantaged person are intact and unaffected. In that case there is no enrichment (and correspondingly no disadvantage).

Illustration 19

X, a debtor of D, is induced by E's fraud of to pay to E sums due to D, E pretending to be collecting the debt on D's behalf. Although X has paid in good faith, X's debt to D is not discharged by the payment. E is of course enriched by X's payment (increase in assets). However, E is not enriched under paragraph (1)(c) in the sense that E has used an asset of D (namely D's right to payment of the debt by X). E has not used that asset because the debt of X to D has not been discharged by the payment to E. D is not prejudiced by the payment. (Equally, and for the same reason, E's enrichment is attributable to X, not D: contrast VII.–4.103 (Debtor's performance to a non-creditor;

onward transfer in good faith), which applies where a right against the debtor is lost. The case is otherwise if D ratifies X's misdirected performance: see further VII.–4:104 (Ratification of debtor's performance of a non-creditor.)

Illustration 20

E takes D's car and transfers it to X in circumstances in which X does not acquire title to the car in accordance with statutory provisions on acquisition in good faith. E has not been enriched by making use of D's right to dispose of title to the car because there has been no transfer of title: X has not acquired ownership. E has merely made use, for a limited period, of D's right to possess the car. The case is otherwise if D ratifies E's purported disposition of the car: see further VII.–4:106 (Ratification of intervener's acts).

Mode of use. Any manner of using an asset which satisfies the foregoing criteria comes within the scope of paragraph (1)(c). In particular, where the asset concerned is property, that property may be used not merely by possession of the thing, but also by other modes of exercising any of the constituent rights, such as a disposition or disposal of the thing. A person who transfers title to another's property to a purchaser in good faith who thereby acquires ownership is enriched by making use of a valuable right of the original owner – the right to transfer title. This is true in a case of gift (so far as the applicable property law allows a non-entitled party to make an effective donation of another's property) no less than in the case of sale because in making an effective gift of another's property the giver purports to appropriate the property quite as much as if the appropriation was for personal use.

Illustration 21

E, a wayfarer, plucks and consumes an apple growing on a tree in D's orchard. E is enriched by appropriation and consumption of the apple.

Illustration 22

E takes D's car and transfers it to X in circumstances in which X acquires title to the car in accordance with statutory provisions on acquisition in good faith. E has been enriched by making use of D's right to dispose of the car.

Illustration 23

E, an electricity generator, purchases coal from D, which is burned in order to generate energy. It subsequently emerges that the contract is void due to non-compliance with regulatory requirements. Even if E did not acquire any property right in the coal, E will have been enriched by destroying it for its business purposes since in that case E has made use of D's rights in the coal.

Interferences not amounting to a use. Not every interference with another's property will amount to a use of that property within the meaning of this paragraph. The requirement of an intentional act of user excludes, among other things, the causation of loss or damage to property or person by a merely inadvertent act. Moreover, a use presupposes that the right is purposefully exercised in order to extract some economically recognisable advantage. A mere wanton act of destroying property, for example, does not by itself constitute an exercise of another's right in this qualified sense of use. Consequently interferences with the rights of others which are not the result of a deliberate act or which are not calculated to appropriate the economic benefits which may be derived from exercising the right do not come within the notion of use of an asset for the purposes of the law of unjustified enrichment. Such matters are the preserve of the law on non-contractual liability for damage.

Illustration 24

E maliciously scratches a parked car belonging to D. E is not enriched within the meaning of this paragraph. D has no claim against E under this Book. Assuming the requirements of VI.–1:101 are satisfied, D has a claim for reparation. The position is no different if the scratch was accidental and the result of E’s negligence or if E was motivated by a thirst for revenge, anarchistic desires, or a perverse thrill from causing destruction. However, the case is otherwise for the law of unjustified enrichment, for example, if E is a professional artist who is working on D’s car to produce an elaborate etching. In such a case E has appropriated the bodywork of the car as the basis for the artwork.

Illustration 25

E agrees with D to store some of D’s furniture while D’s flat is being renovated. D indicates that she will collect it in three weeks time. Forgetful of the arrangement, E goes away on holiday for two weeks just at the time D is due to collect and the furniture can only be collected after E has returned. D demands a fee from E calculated on the basis of hire of equivalent furniture for the period of E’s holiday. D cannot base such a claim on this Book. E has not been enriched within the meaning of this Article. E has never used the furniture and never purported to exercise a right to determine its use. E has merely stored the furniture for a period longer than the parties’ agreement contemplated. Any liability of E arises under the law of non-contractual liability for damage and (if the parties intended to enter a legally binding relationship: cf. II.–4:101 (Requirements for the conclusion of a contract) the law of contract.

E. Non-merger of enriched person’s concurrent or subsequent disadvantage with the enrichment: paragraph (2) of VII.–3:101

General. The definition of enrichment in paragraph (1) of VII.–3:101 (Enrichment) identifies certain forms of benefit (increase in assets, decrease in liabilities, receipt of a service, use of an asset) as constituting enrichments. In this way enrichment is defined in terms of the accretion of particular items which in themselves are valuable. Enrichment is not defined in terms of things which have actually made the enriched person better off. Rather it is defined in terms of receipt or assumption of benefits which are of intrinsic value (in other words, benefits which by themselves tend to make a notional recipient better off). Paragraph (2) of VII.–3:101 (Enrichment) buttresses that definition by making it clear that a person is enriched simply because such a benefit has been obtained. No regard is to be had to any concurrent or subsequent disadvantage. The function of the paragraph is thus essentially one of reinforcement, to prevent the rigour of the first paragraph being diluted by other notions of “enrichment” which would not be suited to the rules contained in this Book.

Enrichment as improvement to net wealth. The function of this approach is best illustrated by contrasting an alternative model of enrichment. Enrichment might be defined in terms of the improvement of an individual’s net aggregate patrimonial position, reflecting an increase in the surplus or reduction in the deficit of assets minus liabilities. The effect of defining enrichment in terms of the extent to which the individual is ‘better off’ is that whenever an individual obtains at the same time both a positive adjustment to assets and an equal and opposite adjustment to liabilities, there will be no enrichment because there is no net improvement to the bottom line of the balance sheet. That approach would not be workable for this draft because it would necessitate special rules to bring within the scope of the law of unjustified enrichment the reversal of benefits conferred pursuant to void or avoided contracts

where there is no ‘net’ enrichment. This may occur if the bargain struck by the parties comes close to the market ideal of an efficient and mutually advantageous transaction and both parties have performed before it is discovered that the contract is void or it is avoided. In order that each party may start from the position of having a claim to restitution of the performance given and a corresponding liability to restore what has been received, it is necessary to adopt an approach to enrichment where one looks separately at each adjustment to the ‘balance sheet’ rather than to their composite effect.

Enrichment on an itemised approach. This is one reason why the draft adopts an ‘itemised’ approach to enrichment and disadvantage. Paragraph (2) of VII.–3:101 (Enrichment) (in conjunction with the corresponding paragraph (2) of VII.–3:102 (Disadvantage)) gives effect to an itemised approach by treating enrichments and disadvantages as distinct matters and excluding a definition of enrichment in terms of an overall improvement in the patrimonial balance. An enrichment is any positive item (within paragraph (1) of VII.–3:101) which is added to the balance sheet and a disadvantage is any negative item (within paragraph (1) of VII.–3:102 (Disadvantage)), regardless of any countervailing movements of value. That enables a situation of exchange to be addressed as a conjunction of two sets of enrichments and disadvantages moving in opposite directions rather than as a single composite transaction.

Illustration 26

S, a provider of services, and P, the purchaser, perform their undertakings under a contract which, it transpires, is void. S is enriched by receipt of the purchase price (increase in assets) and simultaneously disadvantaged by performing the service. P is correspondingly both enriched (receipt of the service) and disadvantaged (decrease in assets: loss of money). Each party potentially has a claim under the law of unjustified enrichment. The value of the service and the amount of the purchase price are immaterial in determining whether a party is enriched or disadvantaged and whether a party has a claim: each is both a claimant in respect of that which was transferred to the other party and a debtor to a claim in respect of that which was received.

Comparison. Of course, where each party to a failed transaction is at the same time both a claimant and a debtor under this Book, there may be scope for set-off. This may result in a resolution of the two claims by one party paying the other the difference in value between the two performances. In such circumstances the approach to the enrichment concept adopted in these principles and the net enrichment approach will produce essentially the same outcome. Nonetheless, the two models do differ in so far as the net enrichment model is only capable of serving economic goals in reversing the enrichment. The natural redress following a net enrichment approach is monetary payment fixed by reference to the net increase in wealth. This does not logically lend itself in cases of mutual transfers to reversals by return in specie of the benefit conferred. It does not facilitate reversal of an enrichment where a party who has transferred a thing to another is eager to recover that thing for sentimental, rather than economic, reasons. In such a case a pure net enrichment approach tends to imply at most a claim or liability measured by the difference in economic value between performance and counter-performance because that is the measure of the enrichment. It effectively compels a set-off. An itemised approach allows for a claim to the thing transferred and this has the potential to protect the broader interest of the claimant in the transfer of the thing as such based on, for example, sentimental attachment or wider business interests.

Contemporaneous and subsequent disadvantage. The principle of paragraph (2) is directed foremost at the case where there is an exchange (i.e. where enrichment and

disadvantage coincide or are contemporaneous), as in Illustration However, the principle is not so confined - as the wording indicates (“in exchange for or after the enrichment”). Any subsequent disadvantage (a disenrichment) is to be disregarded for the purposes of identifying the existence of the enrichment, although it may be crucial for the purposes of the defence under VII.–6:101 (Disenrichment). That is because the concern at this stage is with identifying the enrichment and not with fixing the quantum of liability.

Illustration 27

D puts banknotes, amounting to €400, into an envelope which he hands to E as payment for E’s invoice for work done by E on D’s instruction. The payment due according to the invoice was €250. Subsequently D discovers that, no doubt because of a failure to separate properly several new banknotes, he has considerably overpaid E. E, however, on opening the envelope and discovering the magnitude of the sum enclosed, assumed that D had enclosed a gratuity and promptly spent €200 on a new coat for his wife. E is enriched under this article by the acquisition of €400. This is unaffected by his subsequent disbursement of €200 for the benefit of his wife. (E’s enrichment is justified to the extent of €250 and unjustified in respect of the €150 which was not due: see VII.–2:101 (Circumstances in which an enrichment is unjustified), C0. However, whether E is liable to make any payment to D is to be determined in the light of VII.–6:101 (Disenrichment), in which context it must be considered whether the subsequent expenditure on the coat (as a disenrichment) satisfies the requirements of that defence.

Illustration 28

By mistake, D pays €200 into E’s bank account. Because D had previously spoken about possibly making a gift to E, E assumes that the money is a present. He withdraws the money from his bank account in cash, intent on treating himself to a new jacket. In the shopping centre he meets a friend who is collecting money for a charity, X. With an acute sense of guilt about his rampant consumerism, E hands over to the charity a €50 note. E is enriched by €200. His subsequent payment of €50 to X is irrelevant to determining the enrichment. However, E’s liability to D under the law of unjustified enrichment will be reduced to €150 if E can establish the defence of disenrichment in good faith on the basis that he has sustained a disadvantage (an outlay of €50) in the reasonable belief that his enrichment was justified and that this outlay is one which he would not otherwise have made.

CHAPTER 4: ATTRIBUTION

VII.–4:101: Instances of attribution

An enrichment is attributable to another’s disadvantage in particular where:

- (a) an asset of that other is transferred to the enriched person by that other;*
- (b) a service is rendered to or work is done for the enriched person by that other;*
- (c) the enriched person uses that other’s asset, especially where the enriched person infringes the disadvantaged person’s rights or legally protected interests;*
- (d) an asset of the enriched person is improved by that other; or*
- (e) the enriched person is discharged from a liability by that other.*

COMMENTS

A. General

Overview. This Article, together with the following articles of this Chapter, addresses a further element of the claim for reversal of an unjustified enrichment, namely the requirement that the enriched person's enrichment is attributable to the claimant's disadvantage. It determines that in certain (relatively straight-forward) circumstances the required connection between enrichment and disadvantage is established. Broadly speaking, it addresses those cases in which the disadvantaged party has directly conferred the enrichment on the enriched party or where the enriched party has extracted the enrichment directly from the disadvantaged party.

Particular instances of attribution. The particular cases catered for in the Article are identified as instances of attribution of enrichment and disadvantage. They are applications of the general requirement of attribution within specific contexts. In this regard they flesh out in concrete cases what is meant by attribution, thus giving more structure and content to the application of the basic rule. Not least for reasons of efficiency they necessarily concentrate on situations which may be formulated at a relatively high level of abstraction.

Non-exhaustive list. The Article purports to do no more than provide a positive list of some scenarios in which a given enrichment is attributable to a given disadvantage. The notion of "attribution" is not defined, nor is the list provided by the Articles in this Chapter an exhaustive enumeration. The latter emerges from the wording of VII.-4:101, which indicates an attribution "in particular" where the enumerated instances apply. It should be evident, however, that in so far as a scenario is addressed by the Articles in this Chapter and attribution is affirmed by them, these rules decide the point. The list is imperative, so far as it goes, and not merely suggestive.

Other scenarios. Accordingly an enrichment may be connected to a disadvantage in a manner which is not set out in this or the following Articles. A case in point is where an asset is transferred from the disadvantaged person to the enriched person not by the act of the disadvantaged person or the enriched person or by the act of a third party, but by an act of nature. There will always be a sufficient element of attribution where enrichment and disadvantage are in mirror image, the claimant's right or enjoyment having become the enriched person's (with no change of form taking place), regardless of how this has been brought about. These Articles therefore allow for a residual set of scenarios which may be worked out on a case by case basis through juristic interpretation. Reasoning by analogy may be a fruitful source for development. However, interpretation must necessarily be constrained by a regard for the sense of the rules in so far as they do address an appreciable range of scenarios. A construction which would make a key ingredient of a particular rule redundant as a requirement for linking one person's enrichment with another person's disadvantage will tend to undermine rather than enhance the coherence of the rules. For this reason where one or more elements of the specific instance are missing the implication must ordinarily be, *e contrario*, that the enrichment is not to be regarded as attributable to the claimant's disadvantage.

Variety of possible attributions. In applying this Article and the following rules of this Chapter it may be helpful to bear in mind that out of one set of facts – especially if these are involved or if they concern three or more parties – a person may be enriched or

disadvantaged in more than one way and that enrichment may be attributable to the disadvantage of one person, though not to the disadvantage of another. The question of attribution, like the question of justification, cannot be examined globally and must be considered from the standpoint of a given pairing. In triangular or chain arrangements of transactions, where A's position in relation to B may depend on A or B's position to C, so that the relation between several or indeed all pairings may have to be considered serially, the complexity of the case is inescapable. This legal complexity is simply a facet of the parties' economic interconnection.

Relation to other Chapters. This Article is concerned solely with the issue of whether or not an enrichment is attributable to a disadvantage. While attribution is an essential element of a claim, its presence does not conclusively determine that the enriched person is liable to reverse the enrichment, even if the enrichment is unjustified, and has nothing to say on the question of quantum of liability.

B. Direct transfer: paragraph (a)

An asset of the disadvantaged person. Paragraph (a) presupposes that the asset which has become vested in the enriched person was the asset of the disadvantaged person. It therefore does not apply where the enriched person's gain is the effect of a transfer by a third party of an asset of the third party unless, looking at the substance of the transaction, the third party is acting only as a cipher who in material terms is merely forwarding on an asset of the disadvantaged person.

Illustration 1

Parents E1 and E2 receive payments of child benefit paid by a public body in respect of their grown up son D, but the money is not applied for D's maintenance. D has no claim under this Book that the money received be transferred to him. The enrichment of E1 and E2 is attributable to transfers by the public body, not D.

Meaning of asset. "Asset" has the same meaning as in Chapter 3. For an elaboration, see Comment B on VII.-3:101 (Enrichment). Since, however, paragraph (a) presupposes that the asset is transferred, this paragraph is necessarily confined to property and other rights capable of transfer.

Transfer by the disadvantaged person. An asset is transferred for the purposes of paragraph (a) if what has been done by the disadvantaged person has had the effect of vesting the property or other right in the enriched person. In effecting the transfer the disadvantaged person may have used a representative. Their involvement will not frustrate the application of paragraph (a); mere ciphers are to be disregarded.

C. Rendering a service or doing work: paragraph (b)

General; meaning of service and work. Paragraph (b) presents little difficulty of application, once it is appreciated that a service may be rendered even where only one or other of the parties is aware that benefit is being conferred. The composite notion of 'service and work' which applies in Chapter 3 also applies here. For an elaboration, see Comment C on VII.-3:101 (Enrichment).

D. Use of another's assets: paragraph (c)

Meaning of asset. “Asset” has the same meaning as in Chapter 3. For an elaboration, see Comment B on VII.–3:101 (Enrichment). Since, however, paragraph (c) presupposes that the asset is used, this paragraph is necessarily confined to rights, such as property rights, which are capable of being used.

Meaning of use. The notion of “use” of an asset is likewise the same as in Chapter 3 and is elucidated in Comment C on Article 3:101 (Enrichment).

Infringements of rights and legally protected interests. The wording of paragraph (c) indicates, in a non-exhaustive manner (signalled by the word “especially”), a typical scenario in which a use of another's assets may occur – namely, where there is an infringement of rights or legally protected interests. This may take the form, for example, of appropriation of property or (partial) usurpation of property rights. The inclusion of ‘legally protected interests’ addresses the case, for example, where the enriched person has made use of a trade secret or other confidential information, but has not infringed any (intellectual property) right as such. In such cases the circulation of the information may be legally protected – sufficient to make it an asset in the hands of the disadvantaged person – but its exploitation is not necessarily an infringement of a right.

Illustration 2

X has misappropriated a vehicle belonging to A, who is subsequently indemnified by the insurer, I. By operation of law, I acquires title to the vehicle as a result. X sells the vehicle to Y who in turn disposes of it to Z, who purchases in good faith. Under the applicable property law Z acquires ownership of the vehicle. I has a claim under this Book against Y. In effecting a transfer of title to Z, extinguishing I's rights in the vehicle, Y has made use of a right of I: Y is enriched under VII.–3:101 (Enrichment) paragraph (1)(c) and I is correspondingly disadvantaged (VII.–3:102 (Disadvantage) paragraph (1)(a) and (c) and the enrichment is attributable to the disadvantage under paragraph (c) of this article.

Illustration 3

Under a contract with bank B, E deposits certain jewels in a safe deposit box. E and D agree that D may make use of E's facility at the bank and accordingly certain jewels belonging to D are also deposited in the safe deposit box. Subsequently the bank is robbed and E's safe deposit box is emptied by the thieves. B, who has no knowledge of the private agreement between D and E, pays compensation to E based on the value of the entire contents of the deposit box, thus compensating E for D's loss as well. E's enrichment is attributable to a disadvantage of D: E has (passively) made use of D's assets in that E has claimed compensation for the loss of property which belonged to D and has thus, for the purposes of this rule, made use of D's title to the jewels.

E. Improvement of another's assets: paragraph (d)

Meaning of asset. “Asset” has the same meaning as in Chapter 3. For an elaboration, see Comment B on VII.–3:101 (Enrichment). Since, however, paragraph (d) presupposes that the asset is improved, this paragraph is necessarily confined to rights, such as property rights, which are capable of being enlarged or supplemented.

Asset of the enriched person. In determining whether or how this paragraph applies, it will be important to determine to whom the asset belongs at the time it is improved. It is the owner of the asset who will be enriched, not subsequent acquirers of the asset (albeit that the owner's unjustified enrichment liability may devolve under other rules on successors in title to the asset).

Illustration 4

An elderly lady, A, living on the terms of a right of habitation in a house belonging to her sister, B, invests considerable sums in the improvement of the property. B subsequently sells the house at undervalue to her son, S. A has no claim under this Book against S based on the investment in the property. A improved an asset of B, not an asset of S.

F. Discharge of another's liability: paragraph (e)

Meaning of liability. "Liability" has the same meaning as in Chapter 3. For an elaboration, see Comment B on VII.-3:101 (Enrichment). Discharge of the liability need not be due at the time the enrichment is conferred. A debt which is repayable only on demand is nonetheless a liability extinguished even if no demand for payment has yet been made by the creditor.

Illustration 5

D pays a cash deposit into E's bank account at the X bank. E's account was overdrawn and the deposit has reduced the overdraft. D's disadvantage in the decrease in assets (loss of money) is attributable to E's enrichment in the decrease in liabilities (reduction of overdraft) because D has discharged a liability of E (E's liability to the X bank in respect of the overdraft).

VII.-4:102: Indirect representation

Where a representative does a juridical act on behalf of a principal but in such a way that the representative is, but the principal is not, a party to the juridical act, any enrichment or disadvantage of the principal which results from the juridical act, or from a performance of obligations under it, is to be regarded as an enrichment or disadvantage of the representative.

COMMENTS

A. General

Overview. This Article addresses globally issues of enrichment, disadvantage and attribution in situations involving representatives who deal with third parties on behalf of their principal, but in their own name or otherwise in such a way as not to indicate an intention to bind the principal. The purpose of the Article is to ensure that in such cases an essential policy is not disturbed – namely, that the reversal of enrichments conferred by parties to a transaction which is without effect is a matter only for the parties to that transaction. It does so by essentially collapsing the legal position of principal and representative in relation to third parties into one, ascribing enrichments obtained and disadvantages sustained by the principal to the representative because the representative is the third party's contractual partner.

Indirect representation. This Article applies only where a contract is concluded (or another juridical act done) on behalf of an undisclosed or unidentified principal in such a way that the representative is, but the principal is not, a party to it. The representative will have acted in

the representative's own name or otherwise in such a way as not to indicate an intention to affect the legal position of a principal (see II.–6:106 (Representative acting in own name)) or will have failed to reveal the identity of an unidentified principal (see II.–6:108 (Unidentified principal)). This Article has no application where the contract is concluded by a representative in such manner as to bind the principal directly (as to which see II.–6:105 (When representative's act affects principal's legal position)).

The problem of the principal who is not a party. The difficulty which the Article seeks to address arises where it is the representative and not the principal who is a party to the transaction with the third person. Difficulty may arise, for example, if the representative, by virtue of authority granted by the principal, has power to dispose of or otherwise make use of an asset of the principal. The effect of a performance of the contract with a third party (such as a contract to sell or let out the principal's goods) will be to inflict a disadvantage on the principal and to enrich the third person (purchaser, hirer, etc). The policy of confining reversal of enrichments obtained under a void contract to the parties to that contract demands that the third person return the goods or account for the value obtained to the representative, the third person's contractual partner. However, in the absence of this Article the disadvantage sustained is not that of the representative, but rather that of the principal. It should be the representative and not the principal to whom the third party's restitution is due. Conversely, performance by the third party may well have directly enriched the principal, but this should not facilitate a claim by the third party directly against the principal (with whom the third party never entered into legal relations).

Illustration 1

P authorises I to sell a specified sculpture. In conformity with his agreement with P, I negotiates a sale with T. I does not disclose that he is only acting as an agent. The contract is concluded between I and T, see II.–6:106 (Representative acting in own name), consistent with P's instructions. As a result of performance of the obligations under the sale contract, the purchase money is paid into P's account and the sculpture is delivered to T. It later emerges that the contract is void for failure to comply with rules governing the movement of cultural artefacts. In accordance with this Article, it is I, not P, who has a claim against T under this Book for a return of the sculpture and it is I, not P, who is liable under this Book to T to return the purchase price. P's disadvantage in loss of the sculpture is treated as a result of this Article as a disadvantage of I, not P, and P's enrichment in acquiring the purchase price is treated as a result of this Article as an enrichment of I, not P.

Illustration 2

A consumer T concludes with I a contract for the hire-purchase of a car. Unknown to T, I is acting on P's instructions and the car belongs to P. The hire-purchase contract is void due to failure to comply with required statutory formalities, this being the mandatory effect prescribed by law. Although P suffers a disadvantage in that use is made of his car, I and not P is entitled to a return of the car because P's disadvantage is to be regarded as a disadvantage of I, the party purporting to perform the contract. Any claim of P will be against I by virtue of their agency relationship.

Internal relationship of representative and principal. The purpose of the provision is only to ensure that restitutionary claims arising out of a failed transaction between one party to a contract and another party who is an indirect representative are confined to those parties. The rules of this Article thus necessarily only apply in relation to claims by or against the third

party. It leaves the internal rights and obligations of the principal and the representative unaffected, except in so far as their content depends on rights and obligations vis-à-vis third parties. There is an impact on the internal relationship between principal and representative only because the existence of rights or liabilities of the representative vis-à-vis the other contract party necessarily must have a bearing on the internal relationship. Thus, for example, the fact that a representative will have an enrichment claim against the third party for a return of the principal's property will generate a liability for the representative to account to the principal. Conversely, the liability of the representative vis-à-vis the third party to reverse enrichments of the principal will create in favour of the representative a right of indemnification by the principal. Hence, the representative will be both debtor and creditor of enrichment claims vis-à-vis the third party and will have both corresponding rights against and obligations to the principal under the internal relationship between principal and agent.

Insolvency or fundamental non-performance of the representative. Exceptions to the principle that unjustified enrichments are to be restored by and to the contractual partner (the representative) and not a hidden participant in the transaction (the principal) can only be justifiable in special circumstances where a direct legal relationship materialises between principal and third party. Under the PECL such exceptional cases were provided for in PECL Articles 3:302 and 3:303, whereby a principal or third party was justified in taking over the intermediary's claims in the event of the intermediary's insolvency or fundamental non-performance. These exceptional cases, which raised difficult questions of policy and for which practitioners acquainted with the recurring problems of representation in a commercial context doubted that the PECL rules provided an appropriate solution, have not been carried forward into these model rules. Accordingly there are no exceptions to the rule in set out in this Article.

VII.-4:103: Debtor's performance to a non-creditor; onward transfer in good faith

(1) An enrichment is also attributable to another's disadvantage where a debtor confers the enrichment on the enriched person and as a result the disadvantaged person loses a right against the debtor to the same or a like enrichment.

(2) Paragraph (1) applies in particular where a person who is obliged to the disadvantaged person to reverse an unjustified enrichment transfers it to a third person in circumstances in which the debtor has a defence under VII.-6:101 (Disenrichment).

COMMENTS

A. General

Overview. This Article adds further content to the requirement of the basic rule that the enrichment be attributable to the claimant's disadvantage by providing for a further instance in which that requirement can be said to be satisfied. It is concerned with the case where the enriched person obtains from a third person something which the disadvantaged person should have obtained. In other words, the performance of the third person is misdirected or intercepted or the third person has innocently forwarded to the enriched person that which was due to be restored to the disadvantaged person. The rule stated presupposes a debtor performing to someone other than the creditor which (in given circumstances) has the result that the debtor is discharged. By this means the payee obtains the fruits of the claim (against the debtor) which the creditor has lost

A particular instance of attribution. The wording of paragraph (1) (“also”) makes it clear that this Article merely adds another case in which attribution is made out. (For general comments on the notion of attribution and the non-exhaustive nature of the provisions in Chapter 4, see Comment A on VII.–4:101 (Instances of attribution).) In this context it is important to note that an e contrario interpretation is compelling, as the following comments outline: in comparable cases in which the requirements of this Article are not satisfied, the assumption must be that the enrichment is not attributable to the disadvantage.

B. The disadvantaged person’s loss of a right against the third person

General. This Article applies only if the claimant has lost a right against the third person in respect of the benefit gained by the enriched person. The decisive factor is whether the disadvantaged person’s claim against the debtor is extinguished. On the other hand, it is immaterial for these purposes whether or not the enriched person can be regarded as having used the disadvantaged person’s claim.

Partial loss of a right. The required loss of a right need not be entire. A diminution or reduction in the extent of a right is a partial loss of a right and may be connected to an enrichment in accordance with this article. Where the third party has rendered a partial performance to the enriched person and is partially liberated from the obligation to the claimant, the enrichment of that person will be attributable to the pro tanto disadvantage of the claimant so as to bring this Article into play.

Rules protective of a third party. Loss of a claim against a third person may arise, for example, because of the operation of protective rules intended to ensure that a debtor acting in good faith is liberated from the debt, even though the performance has been to the wrong party.

Illustration 1

E makes an immediate assignment to D of a debt due to E from X. Notwithstanding that no notice of the assignment has yet been given to X, the assignment is effective to transfer to D the right which E has against X: III.–5:114 (When assignment takes place) paragraph (1) and III.–5:113 (New creditor). X pays E the sum due on the debt before notice of the assignment can be given to X. X is discharged, notwithstanding that X has paid the assignor rather than the assignee, because X had no knowledge of the assignment: III.–5:118 (Performance to person who is not the creditor) paragraph (1). Accordingly D loses the claim against X and is disadvantaged by a decrease in assets. E is enriched by an increase in assets (the money received from X). E’s enrichment is attributable to D’s disadvantage under this Article.

Illustration 2

W makes an immediate assignment to D of a debt due to W from X. No notice of the assignment is given to X, but the assignment is nonetheless effective to transfer the claim. Notwithstanding this assignment, W subsequently makes another immediate assignment to E. E gives X notice of this (second) assignment. X, who has no knowledge of the earlier assignment, performs to E. E has priority over D by virtue of prior notification to the debtor (III.–5:120 (Competition between successive assignees) paragraph (1)). Accordingly X is discharged by paying E: III.–5:120 (Competition between successive assignees) paragraph (2). D’s right to performance is extinguished. Consequently E’s enrichment (receipt of X’s performance) is attributable to D’s disadvantage (loss of a right against X). However, the fact the enrichment is

attributable to the disadvantage does not answer the question whether the enrichment is unjustified or whether E has a defence under Chapter 6.

Illustration 3

D is a holder of certain bearer securities, on presentation of which X is liable to pay a fixed sum. The securities are taken by E who uses them to obtain payment from X. As X has paid in good faith to the holder of the bearer securities, X's debt to D is extinguished. E has been enriched by making use of D's asset (the securities). E's enrichment is attributable to D's disadvantage under this paragraph: E has obtained a sum from X (which was due to D) in circumstances where D has lost the right against X.

Illustration 4

W has died leaving his estate to trustees X1 and X2 on trust for his deceased nephew's children in equal shares. Two of the children, E1 and E2, are personally known to the trustees. However, the trustees X1 and X2 recognise it is possible there are also children of whose existence they do not know. The trustees make appropriate advertisements in order to solicit claims. As no responses are forthcoming, they distribute the estate on the footing that E1 and E2 alone are entitled. In fact, the nephew had also fathered child D, who sometime later gains knowledge of her great uncle's disposition. Although the trustees X1 and X2 were obliged to distribute a one-third share to D, the effect of the measures taken by the trustees X1 and X2 in accordance with the rules of the applicable trust law is to provide them with a complete defence to any claim by D. The distribution by the trustees X1 and X2 of D's share to E1 and E2 has had the effect of destroying D's right against X1 and X2. As to one-third each E1 and E2 have obtained an enrichment which is attributable under this paragraph to D's disadvantage in her loss of rights against the trustees X1 and X2 (the third parties).

Illustration 5

D is entitled to the estate of a deceased person, which includes a claim against X, a debtor of the deceased. Nonetheless E succeeds in obtaining a certificate of inheritance for that estate and on the strength of the certificate collects payment of the debt from X. Because of the special effect of a certificate of inheritance, X is regarded as a matter of law as having discharged his debt to the deceased's successor, even though E was not entitled to the debt. E's enrichment (in obtaining the proceeds of D's claim against X) is attributable to D's disadvantage (in losing the claim).

Third party performing binding instructions. The provision may also apply where directions are given as to the destination of certain assets. The essential elements are that the claimant, in exercise of a right to designate the destination of an asset, gives a direction to a third person (who is obliged to implement that instruction) in favour of the recipient, the third person duly implements the instruction and the recipient is accordingly benefited. Typical cases are where a bank is directed by a customer to make a bank transfer or where a seller of goods who is obliged to deliver to the purchaser's order is required to deliver them to another. In each case the claimant has given a binding instruction to the third person to enrich the recipient which the third person, in discharge of its obligation to the claimant, has implemented. As a result the claimant loses a right to the enrichment which is correspondingly gained by the recipient.

Illustration 6

D, a purchaser of goods, agrees with X, the vendor, that X will deliver the goods to D or such other person as D nominates. D sends a fax to X instructing X to deliver to E. In fact D intended the goods to be delivered to Y and inserted E's name on the fax by mistake. X discharges its obligation under the contract of sale by delivering to E in accordance with the faxed instruction from D. E is enriched by the delivery and this is attributable to D's loss of rights of performance against X which X has extinguished by performance to E. The case would be otherwise if the mistake in delivering to E rather than Y was that of X since in that case X would not discharge its obligation to D (to deliver to Y). In that case D would not lose the right to performance vis-à-vis Y; there would be no decrease in assets for D and thus D would sustain no disadvantage.

Disappointed expectation insufficient. There can be no attribution of enrichment to disadvantage, for example, if the claimant had no right against the third person to an enrichment: a disappointed expectation of benefit does not in any case amount to a disadvantage because the frustration of an expectation is not a loss of an asset.

Illustration 7

Intending to make a gift to his friend D, X delivers an envelope by hand to the home of E, D's neighbour, by mistake. D has no claim against E. Although D has not obtained the money which X intended for him, E's enrichment is attributable to the disadvantage of X, not D. X has sustained a decrease in assets in that it was his money which has been lost. D has not lost any right against X to the money: assuming that X had not bound himself to make the gift, D had no right to be given the money, and in any case in these circumstances a defective performance by X of a binding promise of donation would not extinguish D's right to performance of the promise.

Illustration 8

X engages Y to draft her will according to specified instructions. As a result of a mistake by Y, X's will omits a legacy to her friend D. X executes the will in the erroneous assumption that the will gives full effect to her wishes and subsequently dies. The money which X intended to leave to D passes under the will to X's cousin, E. Since D never had any right to any legacy and had only a hope that X would remember him in her will, D has suffered no disadvantage. E's enrichment in acquiring the legacy is therefore not attributable to any disadvantage of D. Any rights which D has will lie outside the law of unjustified enrichment. D may be entitled under the law of succession to have X's will corrected to give effect to X's true intentions. If that is not the case, then it may be that D has a claim in the law of obligations against Y on the basis that D's frustrated expectation constitutes an actionable damage caused by Y. It will be up to the law of contract to determine whether any claim against Y exists on the basis that D is entitled to damages for loss caused by Y's non-performance of the contractual obligation to X to prepare a will according to X's intent, D being seen as a third party in whose favour Y and X impliedly agreed that Y should be obliged to render performance. (See II.-9:301 (Basic rules) and II.-9:302 (Rights, remedies and defences).) It will be up to the law of non-contractual liability for damage to determine whether D has suffered a legally relevant damage which can be regarded as caused by Y's failure to exercise reasonable care in the preparation of the will. (See especially VI.-2:101 (Meaning of legally relevant damage) paragraph (1)(c): "violation of an interest worthy of legal protection".)

Subsistence of right precludes application without ratification. Equally, the Article cannot apply if the claimant has such a right and has not lost it. Without loss of a right there is no disadvantage and thus there can be no question of attribution in relation to the enrichment. In such cases, however, the claimant can bring the Article into operation by ratification: see further VII.–4:104 (Ratification of debtor’s performance to a non-creditor).

Illustration 9

X, a debtor of D, is induced by the fraud of E to pay to E sums due to D, E pretending to be collecting the debt on D’s behalf. E’s enrichment is not attributable to any disadvantage of D. Although X has paid in good faith, X is not discharged from liability to D and is still obliged to perform to D. Since D still has the right against X, D has sustained no disadvantage. E’s enrichment is attributable to the disadvantage of X, who paid E as a result of the fraud. The case is otherwise only if D ratifies X’s payment to E: see further VII.–4:104 (Ratification of debtor’s performance to a non-creditor).

Illustration 9

D has a life insurance policy with the X company. Under the terms of the insurance contract D is entitled to make a unilateral and revocable nomination of a beneficiary to whom X may pay the proceeds of the policy on D’s death. D makes such a nomination in favour of E. Subsequently D revokes the nomination without making a new one, so that X remains contractually obliged to pay the proceeds on D’s death to D’s successors. On D’s death, X fails to notice the revocation and pays the proceeds of the policy to E. D’s successors have no claim under the law of unjustified enrichment against E. The payment by X to E has not discharged X’s obligation under the insurance contract to pay D’s successors. D’s successors have not lost any right and so have not suffered any disadvantage to which E’s enrichment is attributable. The case is otherwise only if D ratifies X’s payment to E: see further VII.–4:104 (Ratification of debtor’s performance to a non-creditor).

Illustration 10

X, a bank, makes a transfer to E’s account at the Y bank and debits the sum transferred from D’s account. However, D had given no instructions for such a bank transfer, the bank having made a mistake on the basis of an instruction from a different customer. (The situation would be the same if D had given instructions for a transfer which were duly countermanded and X made the transfer in oversight or if X had duplicated a single authorised transfer by mistake.) D has no claim against E. D has not lost any rights; D is entitled under the contract with X to a correction of D’s bank account. X was not obliged to D to make the payment and it is therefore X who has suffered a disadvantage to which E’s enrichment is attributable.

Reduction in value of right insufficient. The mere fact that a claim against the third party has depreciated in value as a result of the third party benefiting the enriched person is not sufficient to bring this Article into play. A depreciation of the claim is not a disadvantage to which the enrichment is attributable. The claimant in such a case has not suffered the requisite decrease in assets because still able to enforce the right against the third party. This corresponds with the basic principle in VII.–3:101 (Enrichment) and VII.–3:102 (Disadvantage) that a mere change in value of an asset does not amount to an enrichment or disadvantage, as the case may be (see Comment B on those Articles).

Illustration 11

X, who owes D € 1 million and other creditors € 2 million, pays € 1 million to E, meaning to put the money beyond the reach of all creditors. Immediately following this payment X is declared bankrupt. As a consequence of the transfer and subsequent insolvency, D's right against X has become virtually worthless. E's enrichment, however, is not attributable to a disadvantage of D. Before the transfer D had a right to payment from X. That right continued to exist after the transfer to E; the effect of the transfer was merely to make performance improbable and thus to devalue D's claim. D has no claim against E in the law of unjustified enrichment. D's redress lies in the law on bankruptcy in setting aside X's payment to E, so as to bring that sum back into the patrimony available for X's creditors and thus to enhance the value of D's right to a proportionate share of the insolvent estate of X.

Effect of insolvency of debtor. The proper response of the legal system in a case such as the last is to ensure that any improper disposition by the third party is reversed in favour of the creditors generally. This is a matter for bankruptcy law, not the law of unjustified enrichment. To hold otherwise would mean that the law of unjustified enrichment might be used by creditors to circumvent the bankruptcy law restrictions on when pre-bankruptcy dispositions may be reversed.

Incurring a debt as an alternative to loss of a right. The Article may apply for the analogous case where, instead of losing a right against a debtor, a person sustains a disadvantage in coming under an obligation to a third party as a result of that third party conferring an enrichment on the enriched person.

C. In particular: onward transfer in good faith: paragraph (2)

Onward transfer as specific application. Paragraph (2) relates to a specific case which falls within the terms of the rule in paragraph (1), but which is made explicit because its deduction from that rule is not transparent. It relates to the case where a person has obtained an unjustified enrichment and then disposed of it in circumstances where the defence of change of position provided for by VII.-6:101 (Disenrichment) will be available. In essence, this is the case where the enriched person is in good faith (in obtaining and disposing of the enrichment) and the disposition is gratuitous. Precisely because the end recipient of the enrichment has received a gratuitous benefit which, in a sense, it was not the enriched person's to give away (since the enriched person was liable under this Book to return it), the end recipient in turn comes under a liability to make restitution. The effect of the disposition by the originally enriched person has been to destroy the disadvantaged person's claim against that first recipient and at the same time to enrich the end recipient: the end recipient's enrichment is attributable to the disadvantaged person's loss of the claim against the originally enriched person.

VII.-4:104: Ratification of debtor's performance to a non-creditor

(1) Where a debtor purports to discharge a debt by paying a third person, the creditor may ratify that act.

(2) Ratification extinguishes the creditor's right against the debtor to the extent of the payment with the effect that the third person's enrichment is attributable to the creditor's loss of the right against the debtor.

(3) As between the creditor and the third person, ratification does not amount to consent to the loss of the creditor's right against the debtor.

(4) This Article applies correspondingly to performances of non-monetary obligations.

(5) Other rules may exclude the application of this Article if an insolvency or equivalent proceeding has been opened against the debtor before the creditor ratifies.

COMMENTS

A. General

Overview. This Article addresses globally issues of enrichment, disadvantage and attribution in situations involving an attempt by a debtor to discharge an obligation owed to a creditor by performing to a third person. It is a sister provision to VII.-4:103 (Debtor's performance to a non-creditor; onward transfer in good faith). That Article is concerned with cases where there is an effective discharge of the debt by performance to a non-entitled party: it recognises that there may be a claim against the recipient who has got what was due to the claimant. This Article is concerned with performances to a non-entitled party which are ineffective to discharge the debt. It confers on the creditor a power to ratify the attempted discharge of the debt. Ratification renders the performance to the third person effective and paves the way for a possible enrichment claim by the (former) creditor against the recipient.

Illustration 1

X, a debtor of D, is induced by the fraud of E to pay to E sums due to D, E pretending to be collecting the debt on D's behalf. Although X has paid in good faith, X's debt to D is not discharged by the payment. However, since X's payment to E was intended by X as a discharge of the debt to D, D may ratify X's performance to E under this article. If D ratifies, X is discharged of liability to D. D has an enrichment claim against E. E's enrichment is attributable to D's because, as a result of the ratification of X's misdirected performance to E, D has lost a claim against X and E has gained the fruits of that claim.

Rationale. This provision enables a creditor who ought to have received a given benefit a direct action to obtain that benefit from the person to whom the debtor misdirected the performance. It avoids the necessity for a more circuitous reversal of enrichment (recipient pays to debtor, debtor forwards to creditor) or a further agreement between creditor and debtor (debtor assigns to creditor, in lieu of performance, the debtor's enrichment claim against the recipient).

B. Scope

Payment of debts and other performances. For the sake of simplicity, the provision is worded in terms of ratification of a debtor's payment of another. However, as paragraph (4) makes explicit, the provision applies equally in respect of non-monetary obligations which the debtor purports to discharge by performing to a person who is not in fact the creditor.

Possible exclusion in cases of insolvency. Paragraph (5) provides that this Article may be excluded by other rules if an insolvency or equivalent proceeding has been opened against the debtor before the creditor ratifies. Where a debtor has performed to the wrong person and has become insolvent, a subsequent ratification has the effect of privileging the claimant creditor and immunising that creditor from the effect of the insolvency. Before ratification the debtor

has an enrichment claim against the recipient and that is an asset in the insolvent debtor's estate, while the unsatisfied creditor has merely a claim against the insolvent debtor's estate for the unpaid debt. The claimant is therefore merely entitled to a dividend from an insolvent estate. After ratification the disappointed creditor has a direct enrichment claim against the recipient of the mistaken payment which, assuming the recipient is solvent, is a valuable asset, while the other creditors of the insolvent debtor have no claim to a share of the money due from the wrongly paid recipient. This shifting of the relative positions of creditors post-insolvency raises policy issues which may justify excluding the operation of this article. As in the case of the sister provision (see Comment B to VII.-4:103 (Debtor's performance to a non-creditor; onward transfer in good faith)), the operation of unjustified enrichment law ought not to disturb the policy decisions of insolvency law; its rules have priority over ratification under this article.

C. Ratification

Entitlement to ratify. Ratification by a creditor of a debtor's misdirected performance is possible only where the debtor has attempted to pay the debt to the creditor. Where a debtor has not discharged the debt as a result of a misdirected performance, the ordinary response is a right in the debtor for restitution under this Book from the recipient. To permit the creditor a direct action against the recipient is an exceptional remedy. It is justified where it was the creditor's claim which the debtor meant to satisfy when the debtor paid to the third party recipient. On the other hand, a creditor should not be able to usurp the debtor's right of recovery from the recipient simply because it would be advantageous for the creditor (in particular: because the debtor has since become insolvent). There must be an intention on the part of the debtor to pay a debt owed to the claimant before the claimant can ratify the payment.

Illustration 2

X, who owes D1 €100, intends to make a gift of €50 to D2. X intends to pay D2 by way of bank transfer. By mistake, X pays €50 into E's bank account instead of D2's. D1 cannot ratify X's payment to E. X did not pay to E in attempted performance of the debt due to D1, but rather as a misdirection of an intended gift to D2. D2 cannot ratify the payment either if (it is assumed) X was not obliged to make the gift to D2. E is liable to reverse the enrichment to X.

Effect of ratification. Ratification has the following effects. It renders the attempted performance of the obligation effective. That extinguishes the debtor's liability to the creditor and the creditor's claim against the debtor. Accordingly it enables the normal rule contained in VII.-4:103 (Debtor's performance to a non-creditor; onward transfer in good faith) (which is applicable to effective discharges of debt by misdirected performance) to be applied. The recipient's enrichment (in having received the fruits of the claim) is attributable to the former creditor's loss of the claim against the debtor. This is provided for by paragraph (2). The further rule (contained in paragraph (3)) that ratification does not operate in relation to the recipient as a consent to the loss of the claim ensures that the enrichment is not regarded as justified by virtue of the ratification.

VII.-4:105: Attribution resulting from an act of an intervener

(1) An enrichment is also attributable to another's disadvantage where a third person uses an asset of the disadvantaged person without authority so that the disadvantaged person is deprived of the asset and it accrues to the enriched person.

(2) Paragraph (1) applies in particular where, as a result of an intervener's interference with or disposition of goods, the disadvantaged person ceases to be owner of the goods and the enriched person becomes owner, whether by juridical act or rule of law.

COMMENTS

A. General

Overview. This Article adds a further set of cases in which the requirement of the basic rule that the enrichment be attributable to the claimant's disadvantage is satisfied. In essence it concerns the case where, as the result of an act of interference by a third person, the enriched person obtains from a third person something which belonged to the disadvantaged person.

A general principle and a specific application. Paragraph (1) sets out a general principle, asserting that in such circumstances the enrichment is attributable to the disadvantage if the third person's interference has been effective to transfer to the enriched person what was the disadvantaged person's. Paragraph (2) seeks to render the abstract rule of paragraph (1) more concrete by spelling out what amounts to the usual application of the principle in paragraph (1). This is where property rights of the disadvantaged person are extinguished and those rights are vested in the enriched person, all as a result of the third person's interference.

Typical cases. Typical cases are where, exceptionally, the enriched person has acquired the disadvantaged person's property from a non-entitled party or where a third party has mixed or joined A's property with B's in circumstances where one will become the complete owner of the whole.

Illustration 1

X steals bricks from the premises of D, a supplier of building materials. X uses the bricks in building a house extension on land belonging to a friend E. E is enriched by acquiring ownership of the bricks through accession to the land and the enrichment is attributable to D's disadvantage (loss of ownership of the bricks) brought about by X's making use of D's right as owner to dispose of the bricks.

Illustration 2

X pours oil belonging to the D company into a reserve belonging to E, where it is mixed with E's stock of oil. If under the applicable rules of property law E is owner of the increased stock, E's enrichment is attributable to D's disadvantage in the loss of the oil added to E's reserve.

Illustration 3

X, who is in possession of goods belonging to D, purports to dispose of them to E. In the circumstances and under the applicable rules of property law, E, who is in good faith, acquires title to the goods. E's enrichment is attributable under this Article to

D's disadvantage in losing ownership. Whether E's enrichment is justified or E has a defence to liability is addressed by other Articles under this Book.

A particular instance of attribution. The wording of paragraph (1) ("also") makes it clear that this Article merely adds another case in which attribution is made out. (For general comments on the notion of attribution and the non-exhaustive nature of the provisions in Chapter 4, see Comment A on VII.–4:101 (Instances of attribution).) In this context it is important to note that an e contrario interpretation is compelling, as the following comments outline: in comparable cases in which the requirements of this article are not satisfied, the assumption must be that the enrichment is not attributable to the disadvantage.

Meaning of use. The notion of use of an asset, which as paragraph (2) implies includes effecting a disposition, is the same as in VII.–3:101 (Enrichment) and VII.–3:202 (Disadvantage). See Comment C to those Articles.

B. Deprivation and accrual

General. This Article only applies if the disadvantaged person has been deprived of rights. If a non-entitled party purports to exercise rights of the disadvantaged person, but fails to achieve the desired effect (because of a lack of entitlement to do so), no use is made of the disadvantaged person's right, no asset is lost by the disadvantaged person and no asset is gained by the enriched person. Indeed, the prospective claimant and the prospective debtor to the enrichment claim are not in fact enriched or disadvantaged. An enrichment, disadvantage and attribution can then only occur if there is a ratification under the following article (VII.–4:106 (Ratification of intervener's acts)).

Illustration 4

X purports by a contract to assign to E copyright which is in fact the copyright of D. The transaction is effective as a contract between the parties to it, but has no effect on D's copyright. X has purported to make use of D's right as copyright owner to dispose of that intellectual property. D has no enrichment claim against E (or X). Because D has not lost the copyright and E has not gained it there is neither disadvantage for D nor an attributable enrichment for E (nor has X made use of D's rights).

VII.–4:106: Ratification of intervener's acts

(1) A person entitled to an asset may ratify the act of an intervener who purports to dispose of or otherwise uses that asset in a juridical act with a third person.

(2) The ratified act has the same effect as a juridical act by an authorised representative. As between the person ratifying and the intervener, ratification does not amount to consent to the intervener's use of the asset.

COMMENTS

A. General

Overview. This Article addresses globally issues of enrichment, disadvantage and attribution in situations involving an attempt by a person to dispose or otherwise use an asset belonging to another in a transaction with a third person. It is a sister provision to VII.–4:105 (Attribution resulting from an act of an intervener). That Article is concerned with cases where there is an effective disposition or other use of the claimant's asset: it recognises that

there may be a claim against the recipient who has got what was the claimant's. This Article is concerned with ineffective dispositions or other use. It confers on the owner of the asset a power to ratify the attempted disposition or use. Ratification renders the transaction with the third person effective and paves the way for a possible enrichment claim by the asset's (former) owner against the intervener.

Illustration 1

E takes D's car and transfers it to X in circumstances in which X does not acquire title to the car in accordance with statutory provisions on acquisition in good faith. E has purported to dispose of an asset belonging to D in a juridical act with a third person (X) and therefore D may ratify under this Article. If D ratifies E's purported disposition to X, the purported transfer will be effective: X will acquire and D will lose title to the car. D will be disadvantaged by a decrease in assets. X will be enriched by an increase in assets. E will be enriched by having made use of D's asset. By virtue of this Article E's enrichment will be attributable to D's disadvantage.

Rationale. The purpose of the Article is to facilitate a claim against an intervener either where it would be impolitic for the claimant to proceed against the end recipient, or where recovery from the intervener is a more worthwhile remedy. The latter may be the case where the ultimate recipient's liability would in any case be diminished (for example, due to gratuitous disposal of the asset received in good faith, giving rise to a defence under VII.–6:101 (Disenrichment)) or where the intervener can be made to account for a substitute enrichment (for example, the proceeds of disposing of the claimant's asset on what, from the claimant's standpoint, were favourable terms). The provision is justified by the fact that the intervener attempted to achieve the outcome which the disadvantaged person permits by means of the ratification. Thus ratification only brings about the state of affairs which the intervener in any case intended to effect. It is not in contradiction of the intervener's intention as manifested in the juridical act with the third party.

Meaning of use. The notion of use of an asset, which as the wording of paragraph (1) indicates includes effecting a disposition, is the same as in VII.–3:101 (Enrichment) and VII.–3:202 (Disadvantage). See Comment C to those Articles.

B. Ratification

Authorisation of the disposition or use. In accordance with paragraph (2), ratification has the following effects. It renders the purported disposition or other use effective. That confers on the third person who dealt with the intervener the rights which the intervener has purported to confer: an attempted sale becomes an effective sale, for instance, as much as if the intervener had been acting as an authorised representative. Accordingly the ratifying party loses the assets disposed of or is burdened with the rights granted to the third party.

Justification of the third party's enrichment. In relation to the third party recipient, the ratifying party has no enrichment claim. The intervener is treated as an authorised representative so that, in accordance with VII.–4:102 (Indirect representation), the disadvantage sustained is not regarded as that of the ratifying party, but of the representative. The enrichment of the third party is justified in relation to the representative by the juridical act between them: see VII.–2:101 (Circumstances in which an enrichment is unjustified) paragraph (1)(a).

No justification of the intervener's use of the asset. In relation to the intervener, however, the ratification does not operate as a consent to the disadvantage sustained. The converse would entirely frustrate the purpose of this rule, which is to facilitate a claim against the intervener. The intervener is enriched by using the disadvantaged person's asset (e.g. by effecting the disposition of the asset to the third party). The intervener's use of the claimant's asset is attributable to the claimant's disadvantage under paragraph (c) of VII.–4:101 (Instances of attribution).

Law on liability for non-contractual damage. As between intervener and disadvantaged person, ratification is not a consent to the disadvantage not just for the purposes of this Book, but also for the purposes of the rules on non-contractual liability for damage. Where concurrent obligations arise because the intervener is liable under both this Book and Book VI, the rule in VII.7–:102 (Concurrent obligations) paragraph (1) applies.

VII.–4:107: Where type or value not identical

An enrichment may be attributable to another's disadvantage even though the enrichment and disadvantage are not of the same type or value.

COMMENTS

Overview. This provision has a very limited function. Its purpose is simply to exclude a limitation which might otherwise be wrongly supposed to be a part of the scheme of the rules. It supplements the rules in paragraph (2) of each of VII.–3:101 (Enrichment) and VII.–3:102 (Disadvantage). Those rules make it clear that the concepts of enrichment and disadvantage are defined in terms of individual items of patrimonial displacement, rather than the net overall effect on patrimonial wealth – in other words, entries in the accounts and not the overall balance. VII.–4:107 adds the clarification that the enrichment need not be the mirror image of the claimant's disadvantage.

Non-equivalence of enrichment and disenrichment immaterial. While enrichment and disenrichment are exact opposites from a conceptual point of view, this does not mean that in any particular case they must in fact be of an equal and opposite nature. In many instances that will indeed be the case. D's provision of a service to E enriches E because E receives a service and disadvantages D because D provides it. Likewise, E's making use of D's right amounts to an enrichment of E and at the same time a disadvantage of D because D suffers E's use of the right. Nonetheless, this kind of exact correspondence is in no way a requirement of the basic rule. It may equally arise, for example, that the enrichment takes one form of patrimonial enrichment (e.g. liberation from an obligation which the claimant has discharged – a decrease in liabilities), while the claimant's disenrichment takes another (e.g. disbursement of money – a decrease in assets). Payment of cash into an overdrawn account would be a classic example of this. Where third parties are involved there is even more potential for enrichment and disadvantage to take different forms: the disadvantage which the claimant has sustained in benefiting a third party may be attributable to the enrichment which the enriched person has received from the third party, but the benefits received and conferred by the third party may be very different.

Illustration 1

Y is a friendly society, engaged in procuring the construction of social housing, and X is its chairman. Acting on behalf of the society, X commissions a building company B to construct a luxury villa for himself and his family. B's invoices are satisfied out of an account of Y. Initially the invoices are covered by payments into the account which X makes. X later ceases to make payments into the account, but B's invoices continue to be met from Y's account until X's scheme is exposed. X has been enriched by the receipt of a service and assets from B (construction of the villa and building materials used in the construction). Y has sustained a disadvantage in making payments (to B).

CHAPTER 5: REVERSAL OF ENRICHMENT

VII.–5:101: Transferable enrichment

- (1) Where the enrichment consists of a transferable asset, the enriched person reverses the enrichment by transferring the asset to the disadvantaged person.*
- (2) Instead of transferring the asset, the enriched person may choose to reverse the enrichment by paying its monetary value to the disadvantaged person if a transfer would cause the enriched person unreasonable effort or expense.*
- (3) If the enriched person is no longer able to transfer the asset, the enriched person reverses the enrichment by paying its monetary value to the disadvantaged person.*
- (4) However, to the extent that the enriched person has obtained a substitute in exchange, the substitute is the enrichment to be reversed if:
 - (a) the enriched person is in good faith at the time of disposal or loss and the enriched person so chooses; or*
 - (b) the enriched person is not in good faith at the time of disposal or loss, the disadvantaged person so chooses and the choice is not inequitable.**
- (5) The enriched person is in good faith if that person neither knew nor could reasonably be expected to know that the enrichment was or was likely to become unjustified.*

COMMENTS

A. General

Overview. This Article sets out the measure of liability and particularises the required mode of reversal of the unjustified enrichment, provided for by the basic rule, where that enrichment consists of a transferable asset. The starting proposition is that the enriched person is required to transfer the asset to the disadvantaged person (paragraph (1)). A transfer in specie is thus the primary response of the law of unjustified enrichment if the enrichment takes the form of a transferable asset. However, in certain circumstances the enriched person may elect instead to pay the monetary value of the enrichment (paragraph (2)). The Article also deals with the case where the enrichment has been disposed of or lost and accordingly can no longer be returned in specie. In that case (so far as liability continues, notwithstanding the loss or disposal: see the defence in VII.–6:101 (Disenrichment)) the starting point is that the enriched person must pay the monetary value of the enrichment (paragraph (3)). However, where the enriched person has traded the asset, there is a possibility that the liability to reverse the enrichment will switch to the substitute representing the proceeds of that trade (paragraph

(4)). The switch results from an election of a party; quite which party may make that election depends on the circumstances. Those circumstances include whether the enriched person is in good faith – a matter defined for these (and other) purposes in paragraph (5).

B. Transfer: paragraph (1)

Transferable asset. This article only applies where the enrichment which was obtained takes the form of a “transferable asset”. The term “asset” in this paragraph bears the same meaning as in VII.–3:201 (Enrichment) paragraph (1)(a),(c) and VII.–3:202 (Disadvantage) paragraph (1)(a),(c) (as to which, see Comment B on those Articles). An asset will not be transferable in the sense of paragraph (1) if the asset is not by its nature transferable, if it is impossible or unlawful to transfer it, or for any other reason transfer must be regarded as out of the question. The issue of transferability must be considered from a pragmatic standpoint. A merely legal or theoretical possibility of transfer will not suffice if the asset would be sterile in that condition or if, in order to prevent it being sterile, the enriched person would be compelled to transfer more than the asset (and thus to sustain a disadvantage going beyond a reversal of the enrichment).

Illustration 1

E has made use of D’s bricks in constructing a building on E’s land and is liable to D under this Book in respect of the acquisition of the bricks. It would be barely feasible for E to return the bricks as such without damaging either the building or the bricks themselves (either of which would be a waste of resources). The bricks are not a transferable asset. Nor is the building a transferable asset. While it might be possible under the applicable rules of immovable property law to transfer ownership of the building as such (leaving rights in the soil beneath in E), this would be a useless asset without rights of access to the building over E’s land, but to grant such rights of access would subtract from E’s patrimony more than corresponds with E’s enrichment. (This is quite aside from the fact that the building as such represents more than the bricks, since it is also in part the product of E’s labour in constructing it.)

Place of performance. This Article does not regulate issues of place of performance. Such matters will determine in effect who bears the burden of the cost of transfer, such as paying for collection or delivery by a carrier. The question of where the obligation to transfer is to be fulfilled – whether the enriched person is obliged to hand over at the disadvantaged person’s place of residence or business or need only make the asset available for collection at his own place – will be determined by the general rules governing place of performance of non-contractual obligations: see III.–2:101 (Place of performance).

C. Election to pay monetary value instead: paragraph (2)

Election to pay value. Paragraph (2) provides that instead of making a transfer the enriched person may elect to pay the monetary value of the enrichment, notwithstanding that it relates to a transferable asset, if a transfer of the asset would cause the enriched person unreasonable effort or expense. There may be circumstances in which, given the cost of transfer involved, no constructive or proper purpose would be served by legal rules insisting on a specific transfer. This is in keeping, for example, with the policy underlying the right to specific performance of a contractual obligation, though the details differ (see III.–3:302 (Non-monetary obligations)). It is predicated on the basis that the legal system should not compel a transfer in specie where complete justice would be done by an award of equivalent value enabling the claimant to obtain a fully adequate substitute. In such circumstances there is no

need to interfere more profoundly with the liberties of the debtor than to compel a payment of value.

Uniqueness of the asset. One factor relevant to determining whether the costs of transfer will be unreasonable is whether the asset transferred is unique. Here regard must be had not merely to the physical and economic or marketable characteristics of the thing concerned. If the enrichment has particular sentimental value (e.g. because it was the favourite material thing of a deceased member of the family), then it may be irreplaceable. Obviously tangibles whose value is almost entirely sentimental (such as love letters) or which are intrinsically unique (such as holograph manuscripts or original artwork) are not enrichments which can reasonably be obtained from another source; payment of its economic value will not enable the disadvantaged person to obtain a fully comparable replacement.

Illustration 2

As a result of undue influence exercised by E over D, D is induced to make a gift to E of a valuable collection of nineteenth century portraits of family ancestors. D subsequently avoids the gift on grounds of undue influence. Assuming that transfer would be both possible and lawful, D is entitled to demand restitution of the portraits. The goods are unique and are of special significance to D. D cannot obtain the like assets from another source. It is extremely doubtful that in the circumstances it could be maintained that E would suffer unreasonable effort or expense in restoring the paintings.

Election by the enriched person. Where the power of election arises, the decision whether or not to transfer is one for the enriched person to make. The claimant cannot insist on a monetary payment if the asset is transferable. The primary remedy for reversal of the enrichment where the asset is transferable is one of transfer and if the enriched person is willing and able (even though not compellable) to transfer, then the disadvantaged person must accept that, unless the parties come to some agreement. The disadvantaged person cannot in effect convert an obligation to restore an asset into a forced purchase by the enriched person by demanding cash value in lieu of a transfer – to the detriment of an enriched person who is willing to surrender the asset.

Monetary value. The meaning of monetary value of an enrichment is explained in VII.–5:103 (Monetary value of an enrichment; saving).

D. Liability to pay monetary value transfer no longer possible: paragraph (3)

General. There can be no question of reversing an unjustified enrichment by transferring the asset if the enriched party no longer has the asset to transfer. This may be due to loss of the asset or its destruction or because it has been given or sold away. In this case, the enriched party is obliged to reverse the enrichment by paying the monetary value of the enrichment instead.

Modifications of liability to pay the monetary value of the enrichment obtained. The principle that the enriched party who can no longer return a transferable enrichment must pay the monetary value of what was obtained is subject to two modifications. Firstly, it may be that the enriched person has disposed of the enrichment in good faith and gratuitously (or at least for less than its full monetary value). In such circumstances liability may be reduced by

virtue of the defence of disenrichment: see VII.–6:101 (Disenrichment). Secondly, where the enriched party obtains some benefit in exchange for disposing of the enrichment, such as a price or a right to a price under a sale of the transferable asset, an election might be made that the proceeds from the disposal of the enrichment (e.g. the price or claim against the buyer for payment of the price) should be handed over instead. (Whether it is the disadvantaged person or the enriched person who may make the election that the enrichment be reversed by transferring the substitute will depend on whether the enriched person disposed of the enrichment in good faith. If such an election is made, the form and potentially also the measure of liability is altered. See Comment C.

Illustration 3

X, a tax adviser, sells the practice with its goodwill to Y, another tax adviser. The contract of sale is void. However, clients of the practice who have since had their affairs dealt with by Y wish to continue consulting Y, whom they much prefer to X. Y is no longer in a position to restore the goodwill of the business to X. Y is therefore liable to X to make a payment corresponding to the value of the goodwill which cannot be restored.

Partial disposition, loss or destruction of the enrichment. The principle of paragraph (3) applies to the extent that the enriched person is not able to transfer the asset. If only part of the asset is disposed of or lost or destroyed and some part remains which can be transferred, there will be an obligation to transfer the retained part alongside an obligation to pay the monetary value of the part which can no longer be transferred.

Illustration 4

V sells P a plot of land. After registration of the transfer, P partitions the land and re-sells one parcel. It later emerges that the contract of sale between V and P was void. P must transfer to P the retained land and pay the monetary value of the parcel of land which P sold on.

Monetary value. The meaning of monetary value of an enrichment is explained in VII.–5:103 (Monetary value of an enrichment; saving).

E. Election that substitute be transferred; good faith: paragraphs (4)-(5)

General. Paragraph (4) provides that in defined circumstances, where the enriched person has traded the original unjustified enrichment for some benefit in exchange, the enriched person comes under a liability to transfer the substitute. This is a departure from the principle set out in paragraph (3) that where the enriched person is no longer able to transfer the unjustified enrichment the monetary value is to be paid. When paragraph (4) applies the enriched person is instead liable once again to make a transfer in specie – in this instance, however, a transfer of the substitute.

Election. The rule that an enriched person reverses an enrichment by transferring the substitute is not automatic. It applies only where an election is made. A party who is entitled to make that election may choose not to exercise this option and instead may rely on the underlying rule (under the preceding paragraph) that liability in a case where the original enrichment has been disposed of is a liability to pay its monetary value. Moreover, it depends on the circumstances which of the parties has the right to make the election. Where the enriched person was in good faith when disposing of the enrichment, it is the enriched person who is entitled to elect in favour of the substitute. Otherwise (i.e. where the enriched person

was in bad faith by the time of the disposition) it falls to the disadvantaged person to choose. In the latter case, however, the choice is subject to the rider that it must be equitable.

Rationale where the enriched person is in good faith. Considerations of fairness justify the right of an enriched person who has been in good faith throughout to elect to hand over the substitute instead of paying the value of the original enrichment. The rule protects the position of the innocent enriched person. It presupposes that the enriched person has defensibly changed position on the basis that the enrichment was apparently justified. If the enriched person were to be subject to the normal rule in paragraph (3) which applies when the original enrichment can no longer be transferred, the enriched person would be compelled in effect to purchase the substitute by paying the value of the original enrichment. This would not be equitable: the enriched person should have the option of surrendering the substitute. This policy – that an innocent recipient of an enrichment is not to be forced into paying to keep it – is also reflected in the special rules governing an enrichment which from the outset is a non-transferable enrichment: see VII.–5:102 (Non-transferable enrichment). This is distinct from the defence in VII.–6:101 (Disenrichment) which is available only to the extent that the value received by the innocent enriched person in exchange is less than the value of the original enrichment.

Rationale where the enriched person is not in good faith. Where the enriched person is not in good faith by the time the enrichment is lost or disposed of, the right of the disadvantaged person to demand the substitute rather than the value of the original enrichment is justified by the countervailing considerations. The rule prevents an enriched person who is (or ought to be) aware of the primary obligation to reverse the enrichment in specie from profiting from a default on that obligation. An enriched person cannot knowingly trade a transferable enrichment for an above market price, pay its monetary value (the market price) and pocket the difference. Precisely because of the culpable nature of the behaviour, the enriched person has no cause to complain if forced to surrender that benefit into which the original enrichment has been converted. Where the enriched person is not innocent, there is nothing to countervail the need to give full protection to the disadvantaged person who may have been deprived of the opportunity to obtain that benefit because kept out of having the asset which ought to have been restored. The enriched person who has culpably traded away what was due to be returned to the disadvantaged person may be regarded as a sort of wrongful (unauthorised) manager of another's affairs. Conferring on the disadvantaged person a right of election enables the 'victim' to adopt the proceeds of that 'self-interested' (rather than benevolent) intervention.

Good faith at the time of loss or disposal. In order for the enriched person to be able to exercise the election in favour of surrender of the substitute, the enriched person must be in good faith at the time of disposal of the enrichment: see paragraph (4)(a). Conversely, where the enriched person is not in good faith at the time of its disposal, the disadvantaged person has the right of election: see paragraph (4)(b). The critical time for determining whether the enriched person is in good faith is thus the moment at which the enrichment is disposed of or lost. The requirement of good faith therefore presupposes that there were good grounds to assume that the enrichment was justified and that this assumption continued until it was acted upon by disposing of the enrichment, or endured until the enrichment was lost. Hence, if (whether on or after acquiring the enrichment) the enriched person learns of the facts demonstrating or indicating that the enrichment is unjustified, the enriched person will cease to be in good faith and if the enrichment is nonetheless disposed of or lost (a) cannot insist on handing over the proceeds in lieu of the monetary value of the original enrichment and (b)

runs the risk that the disadvantaged person will elect to demand the proceeds rather than the monetary value of the original enrichment.

Meaning of good faith. The notion of good faith is defined correspondingly in paragraph (5). The enriched person is not in good faith if aware that the enrichment is unjustified or aware of the facts which are likely to result in it becoming unjustified retrospectively. The latter covers the case, for example, where the enrichment results from another's performance of an obligation under a contract and the enriched person knows of the grounds (be it a mistake, fraud, duress, or the like) which entitle that other party to avoid that contract. Actual knowledge of the facts rendering the enrichment unjustified (or making it likely that it will become unjustified) is not required. It suffices that the enriched person ought to be aware of those facts - that is to say, had the enriched person behaved properly, as a reasonable person would, the enriched person would have appreciated that the enrichment was or was likely to become unjustified because such facts as were evident pointed to a reasonable need for further inquiry. An enriched person will not be in bad faith merely by failing to look behind the apparent facts and double check the integrity of the transaction if everything points towards the enrichment being justified. There is no requirement that the recipient of an enrichment treat it sceptically if in all appearance it seems correct. Nor is the enriched person expected to undertake laborious research where there is some room for doubt if a simple appropriate inquiry seems to confirm the correctness of the enrichment. However, an enriched person is not entitled to feign blindness to obvious facts which cast suspicion on the justification for the enrichment; nor may the enriched person place blind faith in an enrichment whose justification can only be supported by a flight of fantasy.

Restriction of the enriched person's right of election. The principle set out in VII.-5:102(3) (Non-transferable enrichment) serves by analogy as a further implied condition for the existence of the enriched person's right of election. That provision is concerned with non-transferable enrichments and contemplates that an enriched person who has obtained the enrichment in good faith, but on the basis that a price was to be paid or the understanding that the enrichment had a certain value, is at least liable to pay that price or value if (i) that agreement as to the price or value is a genuine one, not vitiated by issues of consent and (ii) the price or value does not exceed the monetary value of the enrichment. The underlying reason for that rule is to ensure that a person who contemplated a certain liability for the enrichment at the time of its voluntary appropriation may legitimately be held to that contemplation so long as this does not exceed the enrichment actually obtained. The same reasoning ought to apply where the enriched person obtains the enrichment in good faith under an agreement genuinely fixing a price or value for that enrichment and subsequently disposes of it to procure a substitute. At the time of disposition, the enriched person assumed that the agreed price or value of the enrichment was to be paid. Consequently, if the enriched person has made an economically unprofitable swap, obtaining something less valuable in exchange for that which the enriched person obtained under the (void) agreement with the disadvantaged person, the enriched person should not be permitted to shift that loss on to the other party, for that would simply confer a windfall on the enriched person. If the enriched person accepted the enrichment knowing that a price was to be paid and that price was fixed genuinely in the agreement, that represents a minimum level to which liability to reverse the enrichment may sink. Before making the swap, the enriched person considered that there was an obligation to pay a (genuinely agreed) price for it, so that any subsequent dealings with the asset should be regarded (to the extent of that agreed price) as at the enriched person's own risk.

Apportionment of substitute. A person enriched without justification will be liable in respect of a substitute only to the extent that it is truly the product of the original enrichment – and not in so far as it is derived from other economic inputs (such as the contributions of third parties or the enriched person’s own wealth or efforts). Where the enriched person trades an unjustified enrichment together with other goods or services, the benefit obtained in exchange is only partly to be regarded as standing in the shoes of the original enrichment. The substitute is therefore to be apportioned as between the two parts which do and do not represent the original unjustified enrichment. The apportionment is to be made on the basis of the proportionate value of those different economic inputs for which the substitute was obtained in exchange.

Rationale for apportionment. Fairness requires that a substitute enrichment which is the product of more than just the original enrichment be apportioned as between the different economic factors for which it was exchanged. An unjustifiably enriched person is liable to reverse the enrichment, but should not be under an obligation to make a sacrifice of wealth going beyond this. To the extent that the substitute represents economic input other than the original enrichment the disadvantaged person has no claim on it. To force the enriched party to surrender the entire substitute in such circumstances would amount to a penalty for the enriched person and an undeserved windfall for the disadvantaged person.

VII.–5:102: Non-transferable enrichment

(1) Where the enrichment does not consist of a transferable asset, the enriched person reverses the enrichment by paying its monetary value to the disadvantaged person.

(2) The enriched person is not liable to pay more than any saving if the enriched person:

(a) did not consent to the enrichment; or

(b) was in good faith.

(3) However, where the enrichment was obtained under an agreement which fixed a price or value for the enrichment, the enriched person is at least liable to pay that sum if the agreement was void or voidable for reasons which were not material to the fixing of the price.

(4) Paragraph (3) does not apply so as to increase liability beyond the monetary value of the enrichment.

COMMENTS

A. General

Overview. This Article sets out the measure of liability and particularises the required mode of reversal of the unjustified enrichment, provided for by the basic rule, where the enrichment which is obtained does not consist of a transferable asset. The enrichment is to be reversed by monetary payment. Depending on the circumstances, the scale of that payment may be any of (i) the full value of the enrichment (paragraph (1)), (ii) the amount which the enriched person has saved by having the benefit of the enrichment (paragraph (2)), or (iii) an amount agreed to be paid for the enrichment (paragraph (3)).

Enrichments which are not transferable assets. This Article will apply only where the enrichment which has been obtained without justification does not take the form of an asset which is transferable. It thus addresses all the cases which fall outside the scope of the

preceding Article. (As to the transferability of assets, see Comment B on VII.–5:101 (Transferable enrichment).) It applies where the enrichment takes the form of an increase in assets, but that asset is not transferable. It will also apply where the unjustified enrichment is by its nature not transferable. This is the case where the enrichment has taken any form other than an increase in assets – in other words, a decrease in liabilities, receipt of a service or work, or a use of an asset of the disadvantaged person.

B. Basic liability: paragraph (1)

Monetary value as maximum liability. The basic liability of a person who is enriched other than by receipt of a transferable asset is to pay the monetary value of the enrichment. This basic liability also represents the maximum liability under this Article. The first alternative measure of liability provided for in paragraph (2) is of relevance only in so far as it reduces liability (“The enriched person is not liable to pay more than”). Likewise, the third possible measure of liability set out in paragraph (3) operates, when applicable, only in so far as it does not increase liability beyond the basic measure of liability: this is explicitly stated in paragraph (4). Under this article, therefore, the enriched person is never liable to pay more than the monetary value of the enrichment.

Monetary value. The meaning of monetary value of an enrichment is explained in VII.–5:103 (Monetary value of an enrichment; saving).

C. Reduced liability: paragraph (2)

Reduced liability. Paragraph (2) provides for a lesser quantum of liability for the enriched person based on what the enriched person has in fact saved as a result of the enrichment. If the saving made by the enriched person exceeds the monetary value of the enrichment, this paragraph will not operate to increase liability beyond the basis measure. It can serve only to reduce liability.

Measure of liability: saving. When this paragraph applies, the liability is to pay no more than the enriched person has saved as a result of obtaining the enrichment. The meaning of a saving is explained in VII.–5:103 (Monetary value of an enrichment; saving).

Circumstances in which liability is reduced. The provision applies if the enriched person did not consent to the enrichment. In other words, the enrichment occurred without the enriched person’s request or participation. It will also apply if the enriched person consented to the enrichment, but was in good faith. The notion of good faith which is defined in paragraph (5) of VII.–5:101 (Non-transferable enrichment) applies correspondingly here. See Comment C to that Article for details. Accordingly the enriched person is protected by paragraph (2) if having no reason to know that the enrichment was or would be unjustified.

Rationale. The purpose of this paragraph is to protect the innocent recipient of a non-transferable enrichment. Whereas the innocent recipient of a transferable asset can reverse the enrichment by the (usually) comparatively painless task of returning the enrichment (that is to say, making it available to the disadvantaged person), the innocent recipient of a non-transferable enrichment can necessarily only reverse the enrichment by a monetary payment and is therefore compelled in effect to purchase what they have enjoyed. A liability to pay the monetary value of the enrichment has the potential to produce injustice if the enrichment was thrust on the enriched person or if the enrichment was accepted in circumstances where it could not be appreciated that there would be a liability to pay for its (full) value. Limiting the

liability is required in order to do justice to the negative aspect of the principle of party autonomy: individuals are not to be forced into exchanges without their consent. In such a case the liability of the enriched person ought generally to be limited to the extent to which the enriched person is, in point of fact, better off. Liability to this extent will leave the enriched person no worse off as a result of the reversal of enrichment; it simply strips away the actual gain, if any.

Illustration 1

Making a mistake as to the address of a new client, D cleans E's windows. E had not requested this service and the cleaning takes place in E's absence. E has not consented to the enrichment and accordingly E's liability in respect of the unjustified enrichment is governed by paragraph (2) of this article. E is liable only for what E has saved. E will have a saving and will be liable accordingly if, for example, (i) E was in the habit of commissioning window cleaning on an ad hoc basis, cleaning was due, and E was able to postpone the next cleaning, or (ii) E cancelled a scheduled window cleaning with another firm without penalty. If, on the hand, E's windows had just been cleaned, or are cleaned shortly afterwards by a regular contractor without regard to C's additional service, E will have saved nothing and liability will be nil.

D. Intermediate liability: paragraphs (3) and (4)

Measure of liability under paragraph (3). Although as a rule an enriched person who has obtained a non-transferable enrichment in good faith should not be made to pay more than what has been saved, there is one situation in which a reduction of liability to this extent would go too far. Paragraph (3) addresses that situation and provides for a measure of intermediate liability – liability which is less than payment of the full monetary value of the benefit, but more than any actual saving resulting from it. The measure of liability under paragraph (3) is determined by a price or value fixed by the agreement pursuant to which the enrichment was provided.

Intermediate liability. The provision operates as a brake on the reduction of liability from monetary value to actual savings, fixing liability at a point in between. It applies only when it results in the circumstances in an intermediate measure of liability. If the price or value agreed was more than the market value of the enrichment (representing its monetary value), the enriched person will not be liable to pay the agreed price, only the lesser sum which is the monetary value as monetary value always constitutes the maximum liability. This rule is provided for expressly in paragraph (4). It follows that paragraph (3) will not be applicable if the enriched person made a bad bargain and agreed to pay more than the objective worth of the enrichment. If the enriched person has actually saved more than the agreed payment, this paragraph will again be immaterial because the enriched person will remain liable to pay what has been saved. Actual savings are in all cases a minimum liability (unless that measure too would exceed the monetary value of the enrichment). Paragraph (3) is only material if what the enriched person genuinely agreed to pay is more than what has been saved, but less than the market value of the benefit obtained.

Rationale. If the enriched person solicited the enrichment on the basis that a price ought to be paid, that may be relevant as showing the enriched person's preparedness to pay for the benefit actually received. It might be, for example, that the enriched person bargained for the enrichment under an agreement which, it later transpires, was void as a contract. Clearly the price agreed under the contract cannot automatically serve as the measure of the enriched person's liability since otherwise reversal of the enrichment would amount to indirect

enforcement of the contract – in direct contradiction of the rules invalidating the contract and giving rise to the unjustified status of the enrichment in the first place. On the other hand, if the enriched person accepted an enrichment in the assumption that it would have to be paid for, there is no hardship in compelling the enriched person to pay the agreed price for the enrichment, provided that the agreed price does not exceed the actual value of the enrichment and the fixing of the price is unaffected by the reasons impairing the validity of the contract. In other words, the basic liability (payment of the monetary value of the enrichment) can be reinstated to the extent that it does not exceed the enriched person's expectations of liability at the time the enrichment was accepted.

A price or value genuinely fixed. A key limitation on imposing intermediate liability (in place of reduced liability measured by actual savings) is that the enriched person should not be held to an estimation of the value of an enrichment which suffers from a defect of consent. If the contract was induced by fraud, for example, or if the enriched person suffers from reduced legal capacity, the enriched person cannot properly be made to pay according to the assessment of the worth of the benefit to be received since that assessment, like the contract, will be tainted by the fraud or lack of capacity. This concern is addressed in this paragraph by the requirement that the price or value of the enrichment be genuinely fixed: the reasons for which the agreement is void or voidable as a contract must not be such as to relate to or cast doubt upon the fixing of the price. The requirement will not be satisfied if the contract was void or voidable (and avoided by the enriched person) for reasons which are relevant to the ability to judge properly the value of the enrichment received. The case is otherwise if the contract is void only for some technical reason which has no bearing on the content of the agreement because the parties' judgements are not affected.

VII.–5:103: Monetary value of an enrichment; saving

(1) The monetary value of an enrichment is the sum of money which a provider and a recipient with a real intention of reaching an agreement would lawfully have agreed as its price. Expenditure of a service provider which the agreement would require the recipient to reimburse is to be regarded as part of the price.

(2) A saving is the decrease in assets or increase in liabilities which the enriched person would have sustained if the enrichment had not been obtained.

COMMENTS

General. This Article defines for the purposes of this Book the concepts of the monetary value of an enrichment and a saving. These concepts feature in fixing the measure of the enriched person's liability when the enrichment is not or is no longer transferable and can therefore only be reversed by a monetary payment.

Monetary value. The definition of monetary value in paragraph (1) takes as its bench mark the objective value of the enrichment determined as the price which would be agreed in a hypothetical sale as the outcome of negotiations between parties genuinely interested in a sale. Where there is a market for the asset or service concerned, there will be mechanisms for determining what that market value is – whether by resort to price listings or similar data or expert valuations. The monetary value may be more or less than a price actually agreed between the disadvantaged person and the enriched person since that price may reflect the

outcome of an inequality in bargaining power, superior skills in negotiations, the unusual needs of one of the parties and other peculiarities.

In particular: composite price of services. The second sentence of paragraph (1) provides a clarification in determining the price of services where the service provider is to incur expenditure in performing the service the costs of which are to be covered by the client, such as building materials to be integrated into the building. In such cases the monetary value of the service equals the total which the client would have to pay, regardless of the fact that typically such sums would be divided into the heads of (i) remuneration for the service provider and (ii) payments on account of materials or reimbursement of fees incurred or similar entries. For the purposes of unjustified enrichment law it is the total cost of obtaining the service which matters, rather than the particular way in which that sum might be allocated to the individual aspects of the service provider's economic output. Where, for example, a bank is instructed to make a payment transfer, the value of that banking service will equal the fee charged together with the sum transferred, since the sum transferred will be recouped from the instructing client's funds.

Saving. A saving, as defined in paragraph (2), represents the amount by which the patrimony of the enriched person has avoided a diminution because the enrichment has been obtained. It occurs whenever (a) the enriched person has received a service or used another's assets, (b) were it not for that enrichment, the enriched person would have procured a benefit of that nature and (c) to do so the enriched person would have had to have paid money or have incurred a debt. There will be no saving if, for the enriched person, the benefit is a pure windfall. Rather a saving presupposes that the benefit has (at least in part) substituted for something which the enriched person would have obtained in any event.

VII.-5:104: Fruits and use of an enrichment

(1) Reversal of the enrichment extends to the fruits and use of the enrichment or, if less, any saving resulting from the fruits or use.

(2) However, if the enriched person obtains the fruits or use in bad faith, reversal of the enrichment extends to the fruits and use even if the saving is less than the value of the fruits or use.

COMMENTS

General. This provision provides for collateral obligations which extend the main obligation to reverse the original enrichment to enrichments arising out of the retention (fruits) or use of that enrichment. It thus enlarges the basic liability under VII.-5:101 (Transferable enrichment) (in relation to fruits, which can be transferred) and VII.-5:102 (Non-transferable enrichment) (in relation to use of the enrichment, which is non-transferable). In contrast to the provisions governing substitutes, the liability to reverse the enrichment from obtaining fruits or use of an enrichment is (i) additional rather than alternative to liability to reverse the original enrichment and (ii) automatic, rather than dependent on any election by the claimant.

Measure of liability. The measure of liability for fruits and use is the same. In each case the enriched person is liable to hand over the fruits or pay the monetary value of the use if the

enriched person was in bad faith when that benefit was obtained. If, however, the enriched person was in good faith at that time, liability is limited to any saving which the enriched person has obtained. The notion of saving is set out in VII.–5:103 (Monetary value of an enrichment; saving) paragraph (2).

Bad faith. The notion of good faith which is defined in VII.–5:101 (Transferable enrichment) paragraph (5) applies correspondingly here. A person who is not in good faith at the time that the fruits or use are obtained is in bad faith at that time. The differential treatment based on the presence or absence of good faith is justified by the consideration that an enriched person who knows or ought to know that an unjustified enrichment must be returned must appreciate that there is no entitlement to any consequential benefits and therefore may justly be held accountable for those further benefits. By contrast the enriched person who obtains such consequential benefits in good faith, not appreciating and having no cause to appreciate that the enrichment is to be reversed, is acting excusably. This favouring of the enriched person in good faith thus mirrors in a sense the like differences drawn in the defence of change of position (VII.–6:101 (Disenrichment)), where there is a diminution of the enrichment to be reversed.

Fruits. The fruits of an asset may be either natural (such as the young born to livestock) or legal (income such as dividends, interest or rent). The liability to reverse them is governed by VII.–5:101 (Transferable enrichment) so that if the fruits cease to be transferable, a liability to pay their monetary value or to hand over a substitute may arise in the same manner as it would for the enrichment from which they stem.

Use. Where assets are returned after a period of possession or other use, a collateral obligation to make payment may arise out of the use made of the asset itself. Such payments will effectively correlate to and compensate for wear and tear. Use of the enrichment must be distinguished from an enrichment which itself consists of a use. This Article is relevant where, for example, an asset is sold which, under the applicable property law rules, does not re-vest in the transferor if the underlying contract of sale is avoided. The core liability is to re-transfer the asset. In addition the transferee will be liable under this Article in respect of use of the asset between transfer and re-transfer. Where by contrast one party is enriched by leasing another's property, the only liability is under VII.–5:102 (Non-transferable enrichment) since the use of the property is the enrichment itself, and this Article has no application.

CHAPTER 6: DEFENCES

VII.–6:101: Disenrichment

(1) The enriched person is not liable to reverse the enrichment to the extent that the enriched person has sustained a disadvantage by disposing of the enrichment or otherwise (disenrichment), unless the enriched person would have been disenriched even if the enrichment had not been obtained.

(2) However, a disenrichment is to be disregarded to the extent that:

(a) the enriched person has obtained a substitute;

(b) the enriched person was not in good faith at the time of disenrichment, unless:

(i) the disadvantaged person would also have been disenriched even if the enrichment had been reversed; or

(ii) the enriched person was in good faith at the time of enrichment, the disenrichment was sustained before performance of the obligation to reverse the enrichment was due and the disenrichment resulted from the realisation of a risk for which the enriched person is not to be regarded as responsible;

or

(c) paragraph (3) of VII.–5:102 (Non-transferable enrichment) applies.

(3) Where the enriched person has a defence under this Article as against the disadvantaged person as a result of a disposal to a third person, any right of the disadvantaged person against that third person is unaffected.

COMMENTS

A. General

Overview. This Article provides for a change of position defence based on disenrichment. It defines the notion of disenrichment, sets out the conditions under which a disenrichment sustains the defence, and establishes the extent of the reduction in liability.

Burden of proof. It falls to the enriched person to establish all the elements of the defence. In particular the enriched person must show that the circumstances set out in paragraph (2) – in which a disenrichment is to be disregarded – do not apply. The enriched person (E) must therefore show, according to the required standard of proof, (a) that E has sustained a disadvantage, (b) that this would not have been sustained if E had not obtained the enrichment, (c) that E has not received an enrichment in exchange for the disenrichment, and (d) either (i) that E neither knew nor ought to have known that the enrichment was unjustified or (ii) one of the two exceptions cases where good faith is not required applies. Moreover, in order that E's claim is not restricted by the terms of paragraph (2)(c) of this Article, E must also establish, should the point arise, (e) (i) that E did not agree to the enrichment, or if so (ii) that the agreement did not genuinely fix a price or value for it.

B. Notion of disenrichment

(a) Forms and manner of disenrichment

General. The first condition for the application of the defence, contained in paragraph (1) of the Article, requires the enriched person to establish that the disenrichment. The enriched party must have sustained a material detrimental change in economic position. Without some element of 'debit' from the patrimonial account there is no case for protecting the enriched person from the claim to reverse the enrichment. It is only if a disadvantage has been suffered that reversal of the enrichment would leave an enriched person worse off than before enrichment.

Forms of disenrichment. The wording of paragraph (1) makes it clear that disenrichment may take the form either of disposal of the enrichment obtained or sustaining some other disadvantage. As a matter of principle disenrichment may take any form of disadvantage (within the meaning of the term in VII.–3:102 (Disadvantage)). For this purpose the rules determining what constitutes a disadvantage giving rise to the claim against the enriched person, will be equally material here. The decisive matter is that, trusting to the apparent

justification of the enrichment and accordingly the right to retain it, the enriched party has parted with wealth or sustained an additional burden (which would not otherwise have been done) so that the enriched person must retain the enrichment if not to be worse off as a result.

Disposal of the enrichment. The form of disenrichment which typifies the defence (and which is given particular recognition by its explicit mention in the wording of the Article) is the disenrichment which arises where the enriched person has disposed of the enrichment itself. This may be described simply as disposal of the asset gained. This form of disenrichment necessarily supposes that the enrichment is by its nature transferable or otherwise capable of disposal. Disposal of the enrichment then constitutes a decrease in assets and thus a disadvantage within the meaning of paragraph (1)(a) of VII.–3:102 (Disadvantage). An enrichment is disposed of in this sense whenever title to that asset is vested by the enriched person in another.

Illustration 1

Despite the effective revocation of a bank mandate which S had granted to her brother B and had entitled B to operate S's account at the bank X, B nonetheless withdraws money from the bank and hands this over to S. On discovering its mistake and not knowing that B has given the money to S, X apologises to S for the lapse and credits S's account with the sum which it allowed to be withdrawn. Because the money withdrawn was handed over to her, S has suffered no loss and thus has no contractual claim against X for damages. X has an unjustified enrichment claim for repayment of the sum credited to S's account: the compensation was given in error and without obligation and thus without legal justification. B was disenriched when he handed the money over to S and has a defence under this Article if he was in good faith, i.e. if he was unaware of the revocation of the bank mandate. If B was in bad faith and has no defence, X has concurrent claims under this Book against both B and S.

Other disadvantages. Since what matters is the overall 'bookkeeping' balance of assets and liabilities – that something of value has been set off against the value of an enrichment - the defence is open to the enriched person whenever, instead of disposing of the enrichment itself, that person's 'minus' corresponding to the 'plus' of the enrichment consists of some other act of disenrichment. Disposal of the enrichment itself thus represents only a specific instance of a general requirement. Any other (equally causally related) disadvantage within the meaning of VII.–3:102 (Disadvantage) will potentially suffice to bring the defence into play.

Illustration 2

E receives from trustees of a trust fund the sum of € 25,000, paid to him ostensibly as a beneficiary under the trust established by a distant relative. Determined to make the most of his unexpected windfall, E spends € 250 on jewellery as a present for a friend. He also makes a gift of his car (worth € 5,000) to his daughter, planning to purchase a replacement using his newly acquired wealth. As he anticipates that the remainder of the sum received from the trustees will produce an equivalent income, E allows his son to occupy rent-free for two months a flat belonging to E which has just become vacant and which E would otherwise have let for € 500 per month. Unknown to E, the trustees had no authority to make the payment and on realising their mistake claim repayment from E. As the trustees were not obliged to pay E and did so by mistake, E's enrichment is unjustified; it is also attributable to the trustees' disadvantage. E is liable to reverse the enrichment, but may have a defence under this Article in view of his partial disposal of the enrichment (outlay on the jewellery), his other patrimonial loss

(gift of the car) and his permitting another to make use of his rights (allowing the son to occupy the flat in lieu of renting it). Assuming the other requirements of the defence are made out, E is obliged to pay back only the balance of €18,750.

In particular: other loss of the assets; loss of other assets. The range of possible disadvantages includes a decrease in assets such as consuming or exhausting the enrichment or permitting it to disintegrate (so far as the nature of the enrichment allows this), or disposing of other patrimonial benefits (for example, other property or rights or money). Disposal of other assets is clearly the only form of disenrichment possible when the enrichment is not by its nature transferable. It may be equally material in any case where the enrichment has not in fact been disposed of, even if it is transferable.

Illustration 3

A debtor X discharges the debt with creditor E using money which X has stolen from D. D's claim is against X. D has no unjustified enrichment claim against E. E was enriched by receipt of the money, but was also disenriched in losing the claim against X (which was extinguished by the payment) and the disenrichment was in good faith.

In particular: incurring obligations. Alternatively, instead of a decrease in rights, reducing the positive side of the economic balance, the disenrichment might take the form of incurring obligations (typically money debts), so as to add to liabilities. The enriched person might assume that the enrichment can be used to finance a fresh debt or at any rate that the enrichment will liberate other liquid assets which can be used to finance the debt. Thus there may be a patrimonial loss (and hence disadvantage) in the form of an increase in debts where the enriched person obtains more credit and thus incurs new or enhanced obligations. The defence may then operate in relation to the obligation to pay interest which is incurred. (The defence is excluded in relation to the obligation to repay the principal sum since this disadvantage is offset by receipt of the principal itself. This is an effect of paragraph (2)(a).)

In particular: allowing use of one's rights. The disenrichment might equally take the form of permitting another to use one's rights: the enriched person is then disenriched by making available to another (a third party) the possession or occupation of property which would otherwise have been used by, or would have generated an income for, the enriched person.

Manner of disenrichment: voluntarily and involuntarily sustained disadvantage. As with the form of disenrichment, the manner of sustaining a disadvantage is not in principle restricted to particular modes of reducing the patrimonial balance. A "disposal" of the enrichment might be a transfer of the property or assignment of the right, if the enrichment takes a transferable form, but an enrichment will also be disposed of in any case where it is voluntarily extinguished, for example by release of personal rights to the debtor. Moreover, while the concept of "disposal" by the enriched person necessarily implies a voluntary act, the umbrella concept of disenrichment (disadvantage sustained) embraces voluntary and involuntary disenrichments alike. That is because what matters is simply the overall balance of the enriched person's wealth. Aside from the required connection between disenrichment and retention of the enrichment, the precise mechanism whereby changes to that balance occur is not of the essence. A deprivation of an enrichment caused by acts of nature or third parties therefore falls squarely within the terms of the article. The exact cause of the loss or destruction is immaterial.

Illustration 4

On behalf of D, an incapacitated person whose patrimony is being administered by X, a purported gift of shares in a foreign company is made by X to E. The transfer of shares is duly registered. The shares are subsequently expropriated by the relevant state. D subsequently regains full legal capacity and claims from E payment of the value of the shares, transfer no longer being possible, on the basis that X had no authority to make the donation (a fact unknown to E). E has a complete defence under this Article because, in losing the shares, E sustained a disenrichment equal to the enrichment.

(b) Fault in causing the disenrichment

Fault in general. An involved question is what role fault in bringing about the disenrichment should play within the framework of these rules. Fault involved in the process of disenrichment may be (1) fault of the disadvantaged claimant; (2) fault of third parties; or (3) fault of the enriched person. Different considerations apply in these three cases.

Fault of the disadvantaged claimant. In the first case, where the fault is that of the disadvantaged claimant, if the enriched party suffers a disenrichment because the claimant was largely responsible for bringing the disenrichment about, the claimant hardly has any grounds for objecting to the defence of disenrichment. In that case, therefore, the basic rules apply unaffected by considerations of fault.

Fault of a third party: claim of enriched person against third party. The same applies where the fault is that of a third party and the risks must be allocated between the disadvantaged person and the enriched person: whenever the enriched person is “innocently” disenriched, the risk of frustration of the claim must lie with the disadvantaged claimant. The difference here, however, is that that fault may generate a claim (most especially within the law on non-contractual liability for damage, but potentially also under, for example, the law of benevolent intervention or other rules of private law) against the third party in respect of the loss. If the asset constituting the enrichment has been damaged or destroyed after it was obtained and the third party who has brought about or is responsible for the damage or destruction is liable to the enriched person as the person entitled to the asset, that right of the enriched person against the third party for reparation in respect of the damage done is something obtained “in exchange for sustaining the disenrichment”. Accordingly, although the enriched person sustains a disenrichment, there is a simultaneous counter-enrichment which constitutes a substitute. In these circumstances the defence is excluded to the extent of the claim of the enriched person against the third party: see paragraph (2)(a).

Fault of a third party: direct claim of disadvantaged person. Of course, if entitlement to the relevant asset vis-à-vis third parties has not passed from the disadvantaged person to the enriched person, it may well be that it is the disadvantaged person who acquires a (direct) claim against the person at fault, but at the same time there will be no relevant disenrichment simply because there was no substantial enrichment in the first place.

Illustration 5

E, a farmer, receives a sheep dog as a gift from D, a dog breeder. The twelve year old son of a neighbour, X, shoots the dog dead while practising with his father’s air rifle. It is assumed that X is liable for the damage caused to E and, under the rules in Book VI, must pay compensation at least equal to the value of obtaining a replacement dog. D claims from E the value of the dog, because D had made a gift of the wrong dog by

mistake and has avoided the gift. (It is assumed that D is entitled to avoid the gift for mistake.) Assuming that ownership of the dog passed under the gift, but reverted on avoidance, then (assessed retrospectively) at the time of the shooting, D was owner of the dog, E being merely liable (under VII.–1:101 (Basic rule) of this Book as well as any applicable property law rules) to return possession of the dog to E (which was all that E enjoyed). X is directly liable to E under the law on non-contractual liability for damage to E's property. The case would be otherwise if under the applicable property law ownership of the asset did not revert on avoidance (or at any rate not in relation to third parties). In that case, where E remains owner, E was liable under the law of unjustified enrichment to transfer to D property in the dog. X has shot E's dog and is liable to E for damage to E's property. Although the death of the dog means that E has sustained a disenrichment (loss of the dog), E has acquired a substitute enrichment in the form of the right of action against X and to that extent is denied the benefit of this defence: see paragraph (2)(a.)

Fault of the enriched person. Although it is a more controversial case, the source of origin of the fault causing the disenrichment should as a matter of principle be regarded as irrelevant even where the destruction or other loss is caused by the fault of the enriched person. The purpose of this defence is to protect the enriched person who has acquired an enrichment and deals with it on the reasonable assumption that it is available to be disposed of, free of obligation to account for it to another or to compensate another in respect of it. In order that the defence can operate the person who disposes of the enrichment and later relies on this defence must have acted in that state of mind which implied a freedom to look upon the enrichment completely as that person's own. If the person, instead of making a gift of the property to another, decides to destroy it, that is that person's prerogative. The party enriched by receipt of Chippendale furniture who resolves to chop it into firewood and ignite it on a bonfire may well not appreciate the value of the enrichment, but the defence is not excluded by deliberate maltreatment. The reasonableness of the enriched person's behaviour in making use of what seems to be available to dispose of freely is not a requirement of the defence that he has disposed of the enrichment in all innocence of an obligation to transfer it to the claimant (though of course in given circumstances out-of-character or perverse behaviour by an otherwise reasonable actor may well suggest a calculating and far from innocent state of mind). Equally loss caused by careless acts or omissions which result in a maltreatment or negligent damage to the asset obtained are also covered. This flows out of the same basic principle, underlying this defence, that those taking enrichments in good faith are entitled to deal freely with what they suppose to be theirs to keep, without risk of subsequent penalty. That freedom extends to the liberty to be careless with assets which are apparently 'one's own' (i.e. in respect of which there seems to be no personal obligation to return them or account for their value).

Illustration 6

D has transferred a ship to E. Although the agreement for the transfer is vitiated, (it is assumed) title to the ship does not revert to D when D avoids the underlying agreement. Due to E's failure to keep the ship in a seaworthy condition, it has already sunk by the time D demands its return. E sustains a disenrichment when the ship is lost and, if E had no reason to know that the transfer could be avoided, has a defence under this Article to D's claim for payment of its value, notwithstanding that E's want of care is responsible for the loss of the ship. Note, however, that if the transfer was part of a bargain, paragraph (2)(c) of this Article (invoking paragraph (3) of VII.–5:102) will restrict the scope of the defence.

Disenrichment by improvement of the enrichment obtained. The Article does not make any special provision for the case where the enriched person improves the asset which the enriched person is liable to return. Special provision appears to be unnecessary as the issues which such improvements raise can be adequately addressed under the rules of this Book without more. The expenditure (decrease in assets) or labour (service or work done) which the enriched person has expended in effecting the improvement is a disadvantage and is capable of constituting a disenrichment triggering the defence under this Article. Of necessity the disadvantage can only be incurred by reason of the enrichment having been obtained since the disadvantage is focused on improving the enrichment. Accordingly the proviso in paragraph (1) cannot apply. Critical will be whether the disenrichment will be disregarded or discounted in accordance with the rules in paragraph (2). Whether the improvement therefore gives rise to a defence so as to limit the enriched person's liability pro tanto, based on the value of the expenditure or labour invested in improving the enrichment, will normally turn on whether the improvement was effected in good faith, i.e. whether the enriched person appreciated or ought to have appreciated that there was a liability to return the asset. If the enriched person is in bad faith, there will be no defence. Moreover the scope in that case for a counterclaim under this Book will be restricted. While the enriched person will have enriched the disadvantaged person by effecting the improvement, the enrichment will be justified if the enriched person knew that there was an obligation to reverse the enrichment by returning the asset. Effecting improvements to the asset with that state of mind will amount to a free and unmistakable consent to the disadvantage (expenditure or labour) for the purposes of VII.-2:101 (Circumstances in which an enrichment is unjustified) paragraph (1)(b).

C. Disenrichments excluded from the defence

General. Paragraphs (1) and (2) provides for four categories of case where a disenrichment in good faith does not support the defence or where the impact of the disenrichment is restricted for the purposes of the defence. Paragraph (1) contains the requirement that there must be a nexus between the disenrichment and the enrichment. Paragraph (2)(a) discounts an enrichment in so far as there is a counter-enrichment serving as a substitute for the enrichment disposed of. Paragraph (2)(b) contains the general requirement that the disenrichment must have been in good faith, but in two exceptional cases even a disenrichment in bad faith gives rise to the defence under this article. Finally, paragraph (2)(c) restricts the defence where the enriched person had obtained the enrichment under an agreement which genuinely attributed a price or value to the enrichment, so that the enriched person contemplated from the outset a liability to pay for it.

(a) Absence of nexus between disenrichment and enrichment

Disenrichment independent of enrichment. The mere fact that the enriched person has suffered some disadvantage is not sufficient to trigger the defence of change of position. The rationale for the defence (which fixes its scope) is the need to protect the enriched person who relies detrimentally on an apparent justification for the enrichment. The disadvantage must be of specific relevance to the obligation to reverse the enrichment and that in turn requires that the disadvantage would not have been sustained but for the existence of the enrichment. In other words, disenrichment must be causally connected to acquisition or retention of the enrichment. Effect is given to this requirement in the proviso to paragraph (1).

Basis of comparison. The disenrichment is not relevant if it is one which would have taken place even if the enrichment had not been obtained. The comparison is between the post-disenrichment status quo and a hypothetical projection of the status quo ante into the future on the assumption the enriched person was never enriched. If the disadvantage which the

enriched person has subsequently suffered was one which, independent of the enrichment, the enriched person would (willingly or involuntarily) have sustained anyway, it is not causally related to the enrichment and not material. Surrendering the enrichment, despite the disadvantage, will not make the enriched person worse off than if never enriched at the outset.

Illustration 7

As a result of a mistaken bank transfer from D, the balance of E's current account is increased by €200 to €1,200. On the following day, E withdraws €150 in order to purchase a birthday present for his granddaughter. D subsequently demands the repayment of €200. E has no defence under this Article if the additional inflow of €200 did not influence his expenditure. This might be because (i) he was oblivious of the transfer, e.g. he never examined the state of his bank account before making the withdrawal, or (ii) he always spends about €150 on a birthday present for his granddaughter, regardless of the state of his finances, or (iii) he would have decided to spend the same sum on his granddaughter's present even if the balance of the account had been €1,000 at the time of withdrawal.

This fundamental test applies regardless of whether the disadvantage takes the form of disposition of the enrichment or any other form. For the purposes of exposition it is helpful to consider first disadvantages sustained involuntarily (theft, destruction) and then turn to those occurring voluntarily (disposition, expenditure).

Involuntary loss of the enrichment. The requirement of causal connection will usually be satisfied where the disadvantage takes the form of loss of the enrichment as such. Where the asset concerned is stolen or destroyed, the enriched person sustains a loss which could necessarily only be suffered by virtue of the fact that that asset had been obtained: the existence of the enrichment is self-evidently a prerequisite for its disappearance. The manner of involuntary loss (be it as a result of an act of nature or the wrongdoing of third parties) is not in itself important.

Unconnected hardship: involuntary loss of other patrimony. The position as regards theft or destruction of the asset constituting the enrichment does not apply correspondingly, as a rule, to the loss of other assets. Whereas a loss of the enrichment itself presupposes it was there to be lost, a reduction in other wealth, subsequent to or contemporaneously with the enrichment, may be merely coincidental and not causally related to obtaining or retaining the enrichment. It is therefore generally immaterial that the enriched person happens to have lost something of equal value to the enrichment and the enriched person may well be unable to establish the defence under this Article. Such misfortune, unconnected as it is to the enrichment, is no more relevant to an obligation to surrender an unjustified enrichment than it is to an increasingly cash-strapped debtor's contractual obligation to pay or a financially hard-pressed wrongdoer's obligation to compensate for damage wrongfully caused.

Illustration 8

As a result of abusive and public hectoring by her husband, D is induced to pawn her jewels at E's pawnbrokers. As E was aware that D's husband was unfairly exploiting D, the contract of pledge between D and E is voidable: see II.-7:207 (Unfair exploitation) and II.-7:208 (Third persons) paragraph (2). D subsequently demands the return of her jewels. E asserts that he has a defence of change of position because, following a 'smash and grab' theft at his premises, valuables have been stolen and, while he retains D's jewels, he has lost others of equivalent value. E has no defence

under this article. The theft suffered by E was unconnected to his possession of D's jewels.

Voluntary disenrichments not predicated by the enrichment. Not every case in which the enriched person deliberately parts with the enrichment will satisfy the causative test. The nature of such a disposal and its motivation must be considered. If it can be established that, if not enriched, the enriched person would in any case have made some transfer of wealth having the same value, by resorting to other assets, the disenrichment must be disregarded. In such a case, the mere coincidental fact that the enriched person has chosen to deploy the particular assets constituting the enrichment rather than some other assets in order to make this "inevitable" expenditure ought not to affect the restitutionary obligation. The expenditure must be exceptional – one which would not have been made in the ordinary course of things.

Obligatory expenditure: pre-existing obligations. One category of case, therefore, where the disbursement does not establish the defence is if the enriched person was already obliged (contractually or otherwise) to pay and would therefore have had to pay, even if the enrichment was not available for that purpose. That is so even if, in the absence of the enrichment, the enriched person would not in fact have been in a position to perform the contractual obligation. The disadvantage must be regarded from a normative point of view as having been predicated by the debt rather than the presence of the enrichment obtained. In any case the decrease in liabilities which results from extinguishing the debt is itself an enrichment which offsets the disadvantage in spending the original enrichment: it is a case of a substitute which precludes the defence from operating (see paragraph (2)(a)).

Illustration 9

D is compelled by E's duress to hand over a cash sum of €500 which E deposits into her current account. E's account immediately prior to the transfer was overdrawn and the transfer reduces E's overdraft. E cannot assert a defence under this Article on the basis that she is disenriched in that she has disposed of the cash by reducing her overdraft. She was contractually obliged to her bank to repay the overdrawn sum and had to discharge that obligation even if not enriched by D. In any case E retains the benefit of the original enrichment in the form of a decrease in liabilities.

Obligations incurred after the enrichment. The position is different for the discharge of debts sustained subsequent to the enrichment (as contrasted with pre-existing debts). The crucial issue is whether there was a relevant disadvantage suffered in incurring the debt in the first place. That in turn raises the issue of whether, in the absence of the enrichment, the enriched person would have incurred the obligation. The basic rule applies: if the enriched person would not have entered into the undertaking if not enriched, the debt incurred is a relevant disadvantage for the purposes of this Article. However, where a debt is incurred in return for some benefit, that benefit may trigger the operation of paragraph (2)(a), so that its effect in reducing liability under this Book will be at least partially muted.

Illustration 10

D, an employer, overpays its employee E €100 per month over a six month period before it realises its mistake. On seeing his apparent additional income, which E attributes to a pay rise, E takes out a second instalment mortgage with a bank in order to finance an extension to his home. Repayments of the mortgage commit E to paying €120 per month. As E would not have taken out the mortgage if he had not supposed his salary had been raised by a comparable amount, E has sustained a disadvantage in

incurring the debt which satisfies the requirement of causal relevance set out in this article. That disadvantage is of course substantially offset by the principal of the loan (a substitute within paragraph (2)(a)), so that only the liability in respect of interest under the loan contract is capable of reducing liability under this Book.

Exceptional relevance of pre-existing obligations. The situation is also different where the obligation is one whose content is enlarged by the acquisition of the enrichment, such as an obligation to dispose of all available funds (or all funds from a given source) which extends to the enrichment in question. A typical example would be a promise to transfer after-acquired property of a given category, the obligation only biting in effect as and when the promisor actually obtains property of that category. In this case the enriched person disposing of the enrichment in compliance with such an obligation (caught in the assumption that it is available to dispose of and that there is no prior restitutionary obligation) has apparently no choice but to make the disbursement. The causative prerequisite is satisfied.

Necessary or usual expenditure and exceptional or extraordinary disbursements. As a rule of thumb, a disposition which amounts to necessary expenditure – expenditure which the enriched person would have had to make in any case – must be disregarded. The enriched person, even if using the enrichment for that purpose, still has the benefit of it and indeed is still enriched because the use of the unjustified enrichment for some necessary reason will have simply saved the equivalent value in other resources. Hence payment of normal outgoings will not found the defence under this Article. Disbursements by individuals to pay for ordinary costs of living, such as money spent on rent, weekly grocery shopping, utility bills (fuel or heating, water, and the like) must be disregarded. Similar observations can be made in relation to businesses for their normal overheads. Moreover, this proposition extends to other usual outgoings, even where these are not essential to basic living or operation of the business, if they are not actually motivated by the fact there is additional affluence due to the enrichment. This refers to recreational expenditure or outlay on entertainment (theatre, concerts, cinema, etc), meals in restaurants or weekend breaks, outings and holidays, and the like, which merely conform to the normal pattern of life of indulging in such activities “from time to time” as opposed to “only when extra money is available”.

Independent liberality: gifts uninfluenced by the enrichment. The same applies correspondingly to donations. Gifts made in the ordinary course of events will tend not to give rise to the defence because these are disbursements which the enriched person would in fact make in any case. Gratuitous dispositions will only come within the scope of this Article to the extent that they are referable back to the enrichment. That will be the case where the donor has decided to make the gift or has increased the amount of the gift only because of the assumption that the unjustified enrichment would not have to be reversed and formed part of the donor’s disposable wealth.

Other exceptional disbursements. In any case where the enriched person has spent money in a way which is out of the normal pattern, it must be determined in each case whether the enriched person, in the light of this newly found wealth, has inflated the person’s customary style of gracious living. There must be a reliant adaptation to the apparent entitlement to the enrichment in order for the defence to apply. When the new wealth is the reason for acquiring durable luxury goods, it must be recognised that the goods acquired may exclude or limit the effect of the defence by virtue of paragraph (2)(a). It is extraordinary “consumed” expenditure which is of most relevance to the defence.

Disenrichments prior to enrichment (anticipatory reliance). The examples hitherto given have assumed a change of position after receipt of the enrichment in reliance on an apparently justified entitlement to the enrichment. An issue arises where a person makes disbursements in anticipation of an enrichment to come. If the subsequently enriched person knew or ought to have known that the transaction was for any reason void or vitiated, that person will know or should know that any enrichment conferred pursuant to it will be unjustified. In that case the anticipatory disposition in reliance on an 'entitlement' to the enrichment will be at that person's own risk: paragraph (2)(b). The question is whether a defence can be made out if the reliance was in good faith, untainted by actual or constructive knowledge of the legal transaction's deficiency.

No general exclusion of anticipatory reliance. In setting out a requirement of causal connection to the enrichment neither the wording nor the principles of this defence makes it an absolute requirement that enrichment precede disadvantage. In certain circumstances the conditions of the defence may be fulfilled by a disenrichment in anticipation of an enrichment which the person at that time supposed would be obtained and reasonably supposed would be a justified enrichment. A distinction needs to be drawn between different scenarios of anticipatory reliance. There is a difference between reliance on a current entitlement to (a past or future) benefit and a further reliance on an act being done in the future (e.g. a voluntary payment being made) which would in any case be necessary to establish an entitlement (a prediction of a future event). Where the latter is at stake there is more than a change of position in the sense of anticipatory reliance on an entitlement; there is a gamble. There is no need for the law of unjustified enrichment to discount the enriched person's preparedness to take risks. An enriched person who is a risk taker does not merit the protection of the defence; liability is merely the realisation of the risk run.

Disenrichment in expectation of a voluntary enrichment. A first class of case of anticipatory reliance is where, for example, in advance of an anticipated gift funds are spent on some exceptional luxury item (such as an additional holiday). As with disbursements in anticipation of an inheritance, this is an expenditure of future capital based on a mere expectancy. If the prospective donor is not obliged to confer the enrichment, the prospective donee's outlay of assets is a disadvantage sustained in the knowledge that there is no legal entitlement to the expected enrichment and no guarantee that it will be received. If the prospective donor is not obliged to make the gift, the anticipated accretion to wealth is necessarily precarious, depending on a transformation of the goodwill of the prospective donor towards the chosen donee from benevolent intention to execution. The would-be donee must accept the risk involved in spending money in 'reliance' on the future gift. The subsequently enriched person has therefore not trusted in the soundness of the enrichment later received (that is to say, the underlying validity of the transaction which supports and justifies it) but has only gambled on a hope. No reliance could have been placed on an actual entitlement because no such entitlement had (apparently) been conferred. The position is comparable to that of a punter betting on the favourite and spending the expected winnings before the race is run.

Illustration 11

On several occasions during his lifetime, D indicated to E, his nephew, that on his (D's) death he would be leaving E his house and landed estate. Assuming that D, who is in the final stages of a terminal illness, would not change his mind and knowing the considerable value of the property that would then come into his hands, E enters into a contract with a firm of builders, B & Co, for the construction of a swimming pool on

the estate. Shortly afterwards, D dies. A will is found, leaving D's land to E, and in accordance with its terms E is registered owner of the land. In fact, it is subsequently identified that the will is void for failure to comply with all of the applicable formality requirements and under the rules of intestate succession it is D's wife, W, who inherits the property. W claims a transfer of the land from E. E asserts that he has changed his position in that he has incurred a contractual liability to B & Co, is not in a position to perform, and consequently must pay damages equal to their positive (profit) interest in performance of the obligations under the contract (see III.-3:701 to III. -3:702). E has no defence under this article. Even though E would not have contracted with B & Co if he had not supposed he would become entitled to D's land, E's disadvantage was incurred before he was enriched and without any obligation on the part of D to confer it. Accordingly E did not rely on any entitlement to the enrichment and his disadvantage is not causally connected to the enrichment in the sense of para. (1).

Disenrichment in expectation of performance under an apparent obligation. The situation will be different, however, where the disadvantaged person has given an assurance of enrichment which might reasonably be understood as constituting a unilateral contractual undertaking to enrich (though in fact that undertaking is for some reason void or voidable). In contrast to the preceding scenario, therefore, there is here a supposition of entitlement to the enrichment (a legal right to obtain a justified enrichment). Moreover, at the time of disenrichment the promisee may legitimately consider that there is an existing enrichment – the holding of a legally binding enforceable promise of enrichment.

Disbursements in context of bargain but in own interest. A final and difficult situation is where the enriched person has incurred costs because of the bargain with the claimant, but they are not directed towards fulfilling the supposed contractual obligation to the claimant. Instead they are directed towards the protection of the enriched person's own commercial interests. (If, by contrast, the disadvantage consists of a performance of obligations under the agreement, that will give rise to a counter-claim in enrichment law and does not need to be factored into the defence of change of position.) Mistakenly supposing the agreement with the claimant to be perfectly valid, the enriched person, for example, takes out insurance or makes other hedging arrangements to protect against non-performance of the 'obligation', or makes arrangements with a third party in respect of receipt of the enrichment which is apparently due from the claimant under the terms of their bargain. A distinction must be drawn between disbursements made in order to guard against the risk that other party or the enriched person will fail to perform under the contract on the one hand and on the other hand disbursements made purely in view of the benefit to be received (such as property insurance or advance payments of storage charges, so far as irrecoverable). The former are made in view of the contract and not the enrichment as such. Only the latter come within the scope of the defence.

(b) Substitutes

Counter-enrichment. If the enriched person has disposed of the enrichment in order to acquire some other asset, or has obtained some other benefit in return for the disenrichment, the defence is likewise excluded; see para. (2)(a). The enriched person who has obtained something in exchange for the disenrichment is not worse off as a result of the disenrichment and therefore does not need the benefit of the defence. In some circumstances the disadvantaged person may claim the proceeds of disposal: see paragraph (4)(b) of VII.-5:101 (Transferable enrichment).

(c) Disenrichments which are not in good faith

Disenrichment in bad faith. As a rule a disenrichment is material only if sustained by the enriched person in good faith (para. (2)(b)). The disenrichment will not have been in good faith if the enriched person either knew or should have known that the enrichment was unjustified: see paragraph (5) of VII.-5:101 (Transferable enrichment).

Actual or constructive awareness of absence of justification. Save for the exceptional case addressed in the proviso, the element of good faith is thus essential to the defence of disenrichment. It is the enriched person's excusable ignorance of the obligation to restore the enrichment to the claimant which renders it unjust to overlook the fact that the enriched person would be worse off (compared with the position before "innocent" receipt or acquisition of the enrichment) if made to restore the enrichment or to pay its full value although no longer having it or its equivalent value. The material question therefore is whether, at the time that the disenrichment takes place, the enriched person should have appreciated that there would be a liability to surrender the enrichment. Expressed positively, the enriched person is eligible to make out a defence of change of position if the enriched person reasonably supposed that the enrichment received was owned and available to be to dispose of – that it was obtained with legal justification.

Constructive knowledge. The requirement that this supposition must be reasonable dictates that constructive knowledge of an obligation to surrender the enrichment precludes the defence of disenrichment in good faith as much as an actual knowledge of such an obligation.

Illustration 12

E, having fraudulently deceived D into letting him appropriate her diamond ring, makes a gift of the ring to his betrothed X. E knew or ought to have known at the time of acquisition by deceit (and thus also at the time of disenrichment) that the enrichment was unjustified. The requirement of good faith as a precondition of the defence of change of position prevents E from immunising himself from an enrichment claim by D by making a voluntary donation of his choice in this way. E should appreciate that his duty is to return the ring to his victim; his perhaps irreversible breach of obligation in presenting it to a third party can hardly constitute an exculpation. As D would not have made a gift of the ring to X, the exception recognised by paragraph (2)(b) does not apply and the defence is inapplicable. E is liable to pay the value of the ring.

False supposition of justification. The good faith aspect of the defence of disenrichment thus requires in substance that the enriched person (wrongly but reasonably) supposes there is some legal justification for the enrichment. The full spectrum of possible suppositions is implied by the terms of Chapter 2 which sets out when an enrichment is or is not with legal justification. Typically the enriched person must suppose either (i) that there was a right to the enrichment as against the disadvantaged person (e.g. under a valid contract) or alternatively (ii) that the disadvantaged person consented to the disadvantage freely and without error.

Illustration 13

A, an elderly and quite naive man, believes the story which is told to him by B, the employee of a bank C, that for reasons of checking internal scrutiny in the bank, it is necessary that a sum of €2,000 will be credited to A's account which A is to withdraw immediately and hand back to B. In this manner B makes use of the inexperienced A for the purposes of B's criminal scheme. A is unjustifiably enriched in relation to C

because B was not authorised to make the transfer. However, it is conceivable that A may be able to establish that in the circumstances A acted throughout in good faith and that consequently the onward transfer of the money to B constituted a disenrichment within the scope of this defence.

Exception: where the disadvantaged person would have been disenriched too. While good faith at the time of disenrichment is generally required, there are cases where the absence of an innocent state of mind should not deprive the enriched person of the defence of change of position. Exceptionally the defence is still available, even in a case where the enriched person was aware of an obligation to reverse the enrichment, if the disadvantaged person would also have been disenriched, even if the enrichment had been reversed. This is set out in the first proviso to paragraph (2)(b). The concluding words of that paragraph envisage the case where the disenrichment was unavoidable in the sense that even if the enriched person had behaved as would normally be required – namely, reversed the enrichment and transferred the asset back to the claimant – the same disadvantage would have been sustained by the claimant. In that case the disadvantage is causally independent of the failure to reverse the enrichment. The enriched person should not be deprived of the right to resist the claim for reversal of the enrichment if the disadvantage sustained was (in this technical sense) inescapable. However, this sense of ‘inevitability’ of the disadvantage is not to be confused with that which is relevant in paragraph (1). For the purposes of paragraph (1), the enriched person must show that the disadvantage was dependent on the existence of the enrichment: it was only sustained by the enriched person because of the enrichment. For the purposes of paragraph (2)(b), by contrast, the enriched person must show that the disadvantage was independent of the location of the enrichment: the disadvantage would have been sustained, whoever had the enrichment.

Exception where the enriched person does not bear the risk of loss. A second exception where good faith at the time of disenrichment is not required, set out in the second proviso to paragraph (2)(b), concerns the case where the disenrichment takes the form of loss of the enrichment due to the realisation of a risk for which the enriched person is not to be regarded as responsible. This exception protects an enriched person who has obtained the enrichment in good faith, but becomes aware that the enrichment is unjustified (and thus ceases to be in good faith) before the loss occurs. An enriched person who learns of the unjustified nature of the enrichment has a reasonable time in which to perform the obligation to reverse the enrichment: see III.–2:102 (Time of performance) paragraph (1). During that period, the enriched person is not to be regarded as an insurer of the asset to be returned. If the asset is lost without fault on the part of the enriched person, the enriched person may invoke the defence of disenrichment and is not liable to pay its value.

Illustration 14

E orders a computer hard drive from supplier D. After completing the transaction, D by mistake sends a second hard drive to E. On opening the package, E realises that D has made a mistake, but does not send it back immediately as she is due to leave for a short trip. On returning home, E discovers that her house has been broken into and the hard drive has been stolen. E has a defence under this article. E received the enrichment in good faith. E was not obliged to return the hard drive immediately; performance of the obligation to reverse the enrichment was not yet due. The risk of loss from theft was not a risk for which E was responsible, assuming that E had taken ordinary precautions in protecting her premises during her absence.

(d) Agreement genuinely fixing the price or value of the enrichment

Defence restricted in case of genuine agreement. The general rule that a disenrichment in good faith triggers the defence is subject to a further limitation. If the enriched party accepts the enrichment under an agreement and that agreement genuinely fixes a price or value for the enrichment, that amount represents a liability to which the defence will not apply: see paragraph (2)(c), pointing to paragraph (3) of VII.–5:102 (Non-transferable enrichment).

Rationale. The reason for this ceiling on the defence is that at the time the enrichment was obtained the enriched person envisaged in any case that such a sum would be due to the other party. The enriched person took on the enrichment knowing that it would have to be paid for at the agreed price. To that extent the enriched person does not merit the benefit of a defence of disenrichment. The enriched person is aware at the time of acquisition that to this extent the risk of any disposal of the enrichment must be accepted; the assumption is that there is a liability to pay the agreed amount at the time of the disposal.

E. Extent of the defence

General pro tanto reduction. Under paragraph (1), the liability of the enriched person is reduced to the extent of the disenrichment. The protection which the defence provides is the minimum reduction in liability which is necessary to prevent the enriched person from being worse off as a result of the change of position. The enriched person has a defence only to the extent of the disadvantage sustained.

Rationale. This principle follows from the rationale whereby the enriched person merits protection only to prevent the enriched person being worse off in comparison with the status quo before enrichment. If, after sustaining the disadvantage, the enriched person remains “better off” then there is still scope to that extent for the enriched person to disgorge the enrichment. Hence, if the enriched person has disposed of only a fraction of the enrichment, there remains a residual liability.

Illustration 15

E, living at 43, Midget Gardens, receives a Black Forest gâteau and a bottle of champagne brought to her door by the D delivery company. As there is no accompanying card, she assumes her husband is up to his familiar romantic tricks and settles down, together with her seven teenage daughters, to devour the cake. In fact D’s dyslexic driver made a mistake and the gifts were in fact destined for F who resides at 34, Magnet Drive. At the end of his shift, the driver realises his mistake and shamefacedly returns to E. The cake has been consumed in good faith and E is not liable to account for it. However, since the champagne bottle remains unopened, this must be handed over.

F. Rights against onward recipient: paragraph (3)

General. This provision may be regarded as unnecessary, but it serves as a reminder that where a person gratuitously and in good faith disposes of an enrichment taking the form of a transferable asset and so has the benefit of this defence, that in itself may provide the basis for a claim by the disadvantaged person against the (new) recipient. This is on the basis that the (originally) enriched person was obliged under this Book to reverse the enrichment, but the making of the onward transfer extinguishes the liability because of this defence, so that the enrichment of the new recipient is attributable to the disadvantaged person’s loss of an

enrichment claim against the originally enriched person: see para. (2) of VII.–4:103 (Debtor's performance to a non-creditor; onward transfer in good faith) and Comment C to that Article.

VII.–6:102: Juridical acts in good faith with third parties

The enriched person is also not liable to reverse the enrichment if:

(a) in exchange for that enrichment the enriched person confers another enrichment on a third person; and

(b) the enriched person is still in good faith at that time.

COMMENTS

General. A provision of this nature is necessary to protect enriched persons in a number of exceptional situations where they will otherwise find themselves under an enrichment liability although they were not a party to the transaction out of whose circumstances the unjustified enrichment essentially arises. It gives effect to the same basic policy considerations protecting good faith acquirers of property (whose enrichments are justified by a rule of law under VII.–2:101 (Circumstances in which an enrichment is unjustified)). Provision to this effect is needed because the rules on good faith acquisition have a limited scope of application. Protection is needed outside that scope where the innocent enriched person who has given value in exchange for the benefit does not acquire a property right.

Illustration 1

As a result of X's improper pressure, D is coerced into selling a boat to X. D subsequently avoids the sale to X and under the applicable rules of property law avoidance of the contract of sale re-vests property in the boat in D. D demands a fee for use of the boat from E, who has chartered it from X. E is enriched in making use of D's boat. He has, however, paid X, with whom he dealt in good faith to obtain the use of the boat. If E has not acquired a property right by his good faith dealings with X (e.g. because the right of a charterer is not characterised as a property right), E will have infringed D's rights by making use of D's asset. That enrichment is not justified by a rule of law (since the property law rules on good faith acquisition do not apply). However, E has the defence under this Article by virtue of his payment to X in good faith in return for use of the boat.

Direct recipients. One field of application of this Article is where the disadvantaged person was obliged to perform to the enriched person under an obligation to a third party, which obligation is void or avoided and affected by fraud, threats or unfair advantage (e.g. of that third party) or the disadvantaged person's own lack of capacity. This forms an exceptional case where the disadvantaged person has a direct claim against the enriched person, notwithstanding that the enriched person is a third party to the underlying juridical act, because the disadvantaged person has not performed freely. See VII.–2:102 (Performance of obligation to third person) in conjunction with VII.–2:103 (Consenting or performing freely) paragraph (2).

Illustration 2

By fraudulent misrepresentations X, a rogue, induces D to transfer money to E, whom X purports to represent. When E receives the money, E provides X with goods because X has deceived E into believing that he represents D. E has obtained an enrichment

(money) which is unjustified in relation to D. However, E has a defence under this Article since E conferred a counter-enrichment on X (goods) in exchange for the enrichment obtained.

Indirect recipients. A second category of case concerns situations in which the enrichment is brought about on the basis of a mediated involvement of the parties to the enrichment claim – i.e. where the enriched person has not received or taken the enrichment directly from the disadvantaged person.

Illustration 3

X takes D's bricks without D's permission and uses them to construct a building on E's land. As a result of X's intervention, E's enrichment (the bricks becoming part of E's property on being fixed to the land) is attributable to D's disadvantage in losing property in the bricks: see VII.-4:105 (Attribution resulting from an act of an intervener) and in particular paragraph (2). However, E will have a defence under this Article if E had contracted X to construct the building and pays or has paid him, assuming that E neither knew nor ought to have known that X had no right to use the bricks.

Illustration 4

By mistake D makes a payment to X. X in turn makes a gift of the money to E. Although D has an unjustified enrichment claim against X, the onward transfer of the money to E – if made by X in good faith – may entitle X to the benefit of the defence under VII.-6:101 (Disenrichment). If (by virtue of that defence to D's claim) X's onward transfer of the money to E has the effect of extinguishing X's liability to D, E's acquisition of the money is an enrichment which is attributable to D's loss of the enrichment claim against X: VII.-4:103 (Debtor's performance to a non-creditor; onward transfer in good faith) paragraph (2). However, E will have a defence to D's unjustified enrichment claim if E conferred on X a counter-enrichment in exchange for the money in good faith (i.e. if X handed over the money as payment of the price in a sale, E selling goods or services to X).

Exchange. The defence only applies in so far as an enrichment is conferred in exchange for the one obtained. This means in particular that the enrichment which is actually obtained must be the enrichment contemplated by the transaction with the third party. The mere fact that the enriched person has benefited a third party in the expectation of receiving something which is indeed received from the disadvantaged person will not protect the enriched person if the covering transaction is more limited in scope.

Illustration 5

Under the terms of a lease of a hotel complex D is obliged to pay her landlord, L, a year's rent equal to 20% of the income from the complex, subject to a minimum liability of €28,000. L assigns its claim to rent to its bank, E, and gives D notice of the assignment. D makes a payment to E to discharge her obligation to pay rent, but by mistake pays some €54,000 rather than the mere €28,000 which is in fact due. D is entitled to repayment from E of the excess. Even if L represented to E that the rent due was €54,000 and thereby induced E to accept the assignment in lieu of a debt due from L to E, E's enrichment as regards the excess payment remains unjustified in relation to D. The defence under this Article does not apply to the excess, notwithstanding that E has enriched L (by releasing L from its debt). Properly analysed, E's enrichment of L

was not in exchange for a payment from D as such (the enrichment conferred by D), but rather in exchange for L's claim against D. That the value of this claim was misrepresented so that E expected from D a sum greater than that to which E was in fact entitled does not prejudice D.

Good faith. The notion of good faith applicable for the purposes of this Article is the same as in VII.-5:101 (Transferable enrichment) paragraph (5).

Illustration6

K, an employee of a public finance body D, has authority to make transactions relating to an account containing public funds in order, among other things, to reimburse travel expenses incurred by those acting in the public service. He misuses this authority to pay money from the account to a prostitute P in satisfaction of debts which he owes her. The prostitute P could not sensibly assume that her services might legitimately be paid for from a public account on the instructions of her debtor. She should have appreciated that the bank payment was wrongful. Consequently, P is liable to repay the money to D.

Extent of the defence. In contrast to the defence under VII.-6:101 (Disenrichment), this defence, if established by the enriched person, is a complete defence. Liability is excluded entirely and not merely reduced by the amount of the enriched person's disadvantage (the enrichment which the enriched person conferred on the third party). This promotes legal certainty and the commercial circulation of property more effectively than merely limiting enrichment liability on a pro tanto basis. Having effectively purchased the benefit in good faith, the recipient is assured that there will be no unjustified enrichment liability to any third parties.

VII.-6:103: Illegality

Where a contract or other juridical act under which an enrichment is obtained is void or avoided because of an infringement of a fundamental principle (within the meaning of II.-7:301 (Contracts infringing fundamental principles)) or mandatory rule of law, the enriched person is not liable to reverse the enrichment to the extent that the reversal would contravene the policy underlying the principle or rule.

COMMENTS

General. This provision draws on the provisions in Book II, Chapter 7, Section 3 (Infringement of fundamental principles or mandatory rules). Those provisions envisage that illegality may have varying impact on the efficacy of a contract, depending on the precise nature and purpose of the illegality and the other circumstances. This provision provides a correspondingly open tool for judicial recognition that a disadvantaged person should not be entitled to recover under this Book in view of an applicable mandatory rule or a fundamental principle.

Illegality and justification. Where the enrichment is obtained by virtue of a contract, a prior question before any issue of a defence under this Article can arise is whether the enrichment is justified – which question will turn on the validity of the contract and accordingly the effect

which the illegality has had on the status of the contract. II.-7:304 (Effects of nullity or avoidance) expressly provides that restitution where a contract is rendered ineffective on grounds of illegality is governed by the law of unjustified enrichment.

Illustration 1

E employs D to undertake cleaning services, but D (as E knows) does not have a work permit. Although D has undertaken the work agreed to be done, E refuses to pay D. Whether or to what extent the contract of employment is valid depends on the application of the provisions in Book II, Chapter 7, Section 3 (Infringement of fundamental principles or mandatory rules). Only if the contract is void is E's enrichment in the receipt of a service unjustified and accordingly only then does the question arise whether E has a defence against D's claim under this Book on the basis of this article.

Illustration 2

D is in the business of supplying radar speed trap detectors which D markets for sale to drivers who are anxious not to exceed the permitted speed on stretches of road which are subject to speed traps. Whether or not the use of such equipment on the highway for the purposes of identifying the existence of speed traps constitutes a criminal offence, its use may be contrary to public policy since it tends to encourage drivers to rely on the fact they will be warned of such devices with the result that they may effectively drive at excess speeds until warned without risk of detection. A contract for the supply of such equipment, where both parties are aware that it will be used for this purpose, is therefore arguably contrary to public policy. On the basis that under the rules of the provisions in Book II, Chapter 7, Section 3 (Infringement of fundamental principles or mandatory rules) the contract is void, this Article will determine whether there will be restitution of the equipment and the price paid – i.e. whether D (the supplier) and E (the recipient of the equipment under a void contract to buy from D) will be able to enforce a reversal of the other's enrichment. The legal consequence will be the same for both claims.

Criterion. This Article envisages that whether or not there is a (complete or partial) defence to an enrichment claim based on illegality will depend on whether in the particular circumstances reversal of the enrichment would support or contradict the policy of the law in recognising the illegality.

Relevant factors. In determining whether the enriched person should have a defence on the basis of illegality the following considerations (which are also relevant in determining whether any underlying contract is valid or enforceable: see II.-7:302: (Contracts infringing mandatory rules) will be particularly material: (a) the culpability of each party; (b) the purpose of the principle or rule which has been infringed; (c) the category of persons for whose protection the principle or rule which has been infringed exists; (d) any sanction that may be imposed under the rule infringed; (e) the seriousness of the infringement; and (f) the closeness of the relationship between the infringement and the act.

CHAPTER 7: RELATION TO OTHER LEGAL RULES

VII.–7:101: Other private law rights to recover

(1) The legal consequences of an enrichment which is obtained by virtue of a contract or other juridical act are governed by other rules if those rules grant or exclude a right to reversal of an enrichment, whether on withdrawal, termination, price reduction or otherwise.

(2) This Book does not address the proprietary effect of a right to reversal of an enrichment.

(3) This Book does not affect any other right to recover arising under contractual or other rules of private law.

COMMENTS

A. Exclusivity of contractual rules: paragraph (1)

General. This Book does not apply in so far as contractual rules purport to address comprehensively an issue of restitution – either by granting a right to restitution or by excluding such a right. In that case the matter is governed by the contract law solution. Where, however, the rules of contract law are silent on the issue of reversal of an enrichment, this Book continues to apply.

Exclusion of a right to reversal of enrichment. Where contract law envisages that there should no reversal of an enrichment and that the matter should be addressed by contract law rules by means of different remedies, it would contradict that regime if unjustified enrichment law were to compel a reversal of the enrichment.

Deviation from terms of the obligation. This provision will be relevant where the enrichment is not ordinarily justified because the performance which has given rise to it did not conform to the contract and accordingly the enriched person had no entitlement to the enrichment under the juridical act for the purposes of paragraph (1) of VII.–2:101 (Circumstances in which an enrichment is unjustified). If a tender of performance does not conform to the contract, the legal consequences are a matter in the first instance for contract law. A right to reversal of the enrichment under this Book may be excluded because the recipient of the goods or services wishes to exercise other remedies, such as a right to repair or replacement, or the provider of the service may have a right to insist on an opportunity to repair without being under an obligation to replace the goods provided. Equally, an obligation on the part of the recipient to reverse the enrichment obtained may be displaced by contract law because this would otherwise contradict the logic of the right to performance. The very fact that a right to reversal of benefit arises where the contractual relationship is terminated indicates that a benefit conferred by a performance which falls short of what is due (a tender of performance which is a non-performance) should not per se give rise to restitutionary claims. The matter depends on the rules on termination of the contractual relationship or interaction with other contractual remedies.

Illustration 1

D, a garage, agrees with E to respray E's car metallic blue. As a result of a mix-up, D sprays the car metallic grey. E is not under an obligation to pay D in respect of the service provided. Rather D is under an enduring obligation (unless and until the contractual relationship is terminated) to re-spray the car the correct colour.

Obligations ceasing to have effect for the future only. Where a contractual relationship is terminated, or a party withdraws from a contract, or in some other way the contractual relationship is ended without retrospective effect, extinguishing only the parties' outstanding obligations and rights to performance, this Book regards enrichments conferred before the termination or equivalent as being justified precisely because there is no retrospective impact on the contractual obligations; the entitlement to the enrichment which has already been satisfied is unaffected. See Comment B on VII.–2:101 (Circumstances in which an enrichment is unjustified). It will be for the special rules governing the termination of contractual relationships, or other prospective terminations of obligations, to determine what right, if any, a party has to recover in respect of the benefits conferred on the other party.

Contractual relationships terminated for non-excused non-performance. The primary specific instance is the exercise of a right to terminate a contractual relationship. Such a right may be expressly agreed by the parties: see III.–1:108 (Variation or termination by agreement). . A right to terminate a contractual relationship arising from a valid contract may also arise by operation of law as a result of the other party's non-performance of obligations. Termination will not avoid the contract retrospectively; it merely discharges the parties from their future obligations: see III.–3:509 (Effect on obligations under the contract) paragraph (1). Thus the contract remains effective and an enrichment which was obtained under the contract before termination is not obtained under a contract which is rendered ineffective retrospectively. Because its primary effects are confined to future operation of the contract, termination merely prevents the contract from providing a justification for any subsequent enrichment (i.e. an enrichment obtained as a result of a performance after termination). III.–3:511 (Restitution of benefits received by performance) and following Articles entitle each party to claim restitution of benefits conferred under the contract before termination. An effect of VII.–7:101 is to express the principle that those rules are not affected by this Book. The availability of a claim under contract law for reversal of benefits confirms that there is no need for a parallel regime under this Book.

Illustration 2

D and E conclude a contract by which E, the owner of premises, agrees to enter into a lease of them with D. It is part of the agreement of the parties that D will make improvements to the premises. D commences work on the improvements, but because they are being completed too slowly E terminates the relationship. D's claim for any benefit conferred on E by virtue of improvements to E's property is governed by the rules setting out the restitutionary consequences of termination of a contractual relationship and correspondingly this Book does not apply.

Contractual relationships terminated for excused non-performance (frustrated contracts). Where a contractual relationship is terminated for excused non-performance (i.e. in essence frustrated), the obligations of the parties which were originally agreed are re-fashioned by contract law into contractual obligations to restore or make payment for benefits obtained. This is achieved by allowing a party to resort to the remedy of termination (III.–3:101 (Remedies available) where the other party is impeded from performing and the non-performance excused on that basis (see III.–3:104 (Excuse due to an impediment)). Termination for excused non-performance (as in the case of termination for non-excused non-performance) enables the parties to recover under III.–3:511 (Restitution of benefits received by performance) and following Articles benefits conferred under the contract. Here again enrichments obtained as a result of a performance before the frustration remain justified (and an enrichment claim correspondingly excluded) because they have been conferred under a

contract which, despite termination of the resulting relationship for non-performance, remains valid: on termination the obligations of the parties are discharged only in respect of future performance. The contract is not rendered ineffective with retrospective effect. In this regard whether termination is for an excused or a non-excused non-performance is immaterial for the purposes of the rules in this Book since the effects of termination are the same.

Exercise of a right of withdrawal. A second case where a contractual obligation may cease to have effect for the future only is where a contractual relationship comes to an end as the result of the exercise of a right of withdrawal. The effect of exercising a right of withdrawal is not to annul the contract retrospectively, but only to end the contractual relationship from the time the right is exercised: II.-5:105 (Effects of withdrawal) provides that withdrawal terminates the contractual relationship and (in slightly modified form) the general restitutionary rules for termination of contracts apply. Accordingly, an enrichment obtained as a result of one party performing an obligation under a contract which is subsequently cancelled is an enrichment to which a person is entitled by virtue of a valid contract and is justified under VII.-2:101(1)(a) (Circumstances in which an enrichment is justified). Rights to restitution of benefits conferred before withdrawal remain a matter of contract law.

Obligations subject to resolutive conditions. Another case where an obligation may cease to have effect for the future only is where it is made conditional upon the occurrence of an uncertain event so that the obligation comes to an end if the event occurs: see III.-1:106 (Conditional rights and obligations) paragraph (1). The effect of fulfilment of such a resolutive condition is that the obligation comes to an end (unless the parties otherwise agree): III.-1:106 (Conditional rights and obligations) paragraph (3). For the purposes of the law of unjustified enrichment, the situation is the same as for contractual relationships coming to an end by the operation of a right of termination or withdrawal: the determination of the obligation does not render the entitlement void with retrospective effect. Accordingly an enrichment conferred in performance of a contractual obligation subject to a resolutive condition which is subsequently fulfilled is justified, notwithstanding that the contractual obligation later comes to an end. III.-1:106 (Conditional rights and obligations) paragraph (5) provides that the restitutionary effects are likewise regulated by the contract law rules set out in III.-3:511 to III.-3:515 (Liabilities arising after time when return due). The case is otherwise only for performances rendered after the condition has been fulfilled and the contractual obligation has ended or if the agreed effect of the contract is to make the contract retrospectively null.

Deviations from contract to which contract law rules do not apply. Paragraph (1) only applies in so far as the rules governing the juridical act regulate or oust a claim to restitution. Hence where the contractual performance tendered is outside the four corners of the contract (e.g. because the party tendering has made a fundamental mistake as to what was demanded) and contract law is silent on the matter of restitution (neither granting a restitutionary claim against the other party to the contract, nor excluding such a claim), the enrichment is not justified, even though a valid contract is part of the background to the case.

Illustration 3

X, a customer of a bank, instructs D, the bank, to make a payment to Y. As a result of its own carelessness, D makes a payment in the correct amount to E (instead of Y) in the mistaken assumption that this was the instruction given by X. E's enrichment is obtained as a result of D's attempted discharge of an obligation (owed by D to X), but the performance was not in conformity with the terms of the obligation and does not

discharge it. The rules of contract law do not confer on D a right of restitution in respect of this payment; nor do they exclude it. Under contract law the payment is simply a non-performance which has conferred no benefit on X. Accordingly, this Book applies so that D has a right to reversal of the enrichment against E.

Frustrated purpose or disappointed expectation. The principle that this Book grants no right to reversal of the enrichment where the contract is valid and a right to reversal of the enrichment under contract law depends on termination of the contractual relationship (since it would contradict the insistence of contract law on termination if a right were granted) applies even where the disadvantaged person has conferred the benefit without obtaining anything in return – in other words, where there is a complete failure of counter-performance. If the contract is valid, the fact that an expectation is disappointed or a purpose frustrated (and the enrichment unjustified under paragraph (3) of VII.–2:101 (Circumstances in which an enrichment is unjustified), notwithstanding that the recipient has an entitlement under the contract), the fact that the claimant never receives in return what was anticipated under the contract will not found a claim under this Book. Given that the enrichment has been conferred in performance of an obligation under a subsisting contract, any redress in that case is contractual by exercising a right to terminate the contractual relationship for fundamental non-performance.

Illustration 4

D, a purchaser of goods, pays a deposit to E, the vendor, in accordance with the terms of the contract of sale. Before delivery falls due, D notifies E that she will not accept delivery. If D is in anticipatory breach of her obligation to take delivery, E has a right to retain the deposit. Although D paid the deposit to E only as part of a performance in exchange for E's goods, D has no claim under the law of unjustified enrichment to a return of the deposit even though she has not obtained the counter-enrichment she expected at the time of payment of the deposit.

B. Proprietary effect of a right to recover: paragraph (2)

Proprietary claims. This Book provides for a personal claim to reversal of an enrichment. It does not determine in what circumstances a proprietary claim (be it vindication of property or a claim in the nature of proprietary tracing) should exist. Such matters are not addressed by this Book. Nor does this Book determine what rights to recover (including rights under this Book) ought to be regarded as having proprietary effect (so that an enrichment creditor has priority over unsecured personal creditors of the enriched person).

C. Rights to recover under other private law rules: paragraph (3)

General. Specific rights to recover in respect of benefits conferred may be encountered in all fields of private law. This includes rights which arise under contract law where this Book would regard the enrichment as justified and would therefore not grant an enrichment claim. Property law confers a right to vindicate property which may operate concurrently with a right to reversal of the enrichment where the enrichment is possession of another's property. Regard must be had also to rights elsewhere in the law of obligations, such as the right of reparation under rules on non-contractual liability for damage (and see especially VI.–6:101 (Aim and forms of reparation) paragraph (4), providing for recovery of an advantage obtained by the person causing the damage), the right of a principal against a benevolent intervener to delivery up of all that the intervener has obtained in the course of the benevolent intervention (V.–2:103 (Obligations after intervention) paragraph (1)) and rights of recourse between solidary debtors.

Illustration 5

S sells an appliance for weighing animal feed to B, an agricultural business. It transpires that the contract is void and under the applicable property law title to the appliance is regarded as not having passed. S sues B for surrender of the appliance on the basis of S's (retained) ownership. S also demands compensation from B for the deprivation of use from the time of transfer of possession to B to its return. S may legitimately sue on the basis of non-contractual liability for damage caused to another, invoking VI.-2:206(2)(a), if the other requirements of liability under VI.-1:101 are satisfied (in particular: negligence on the part of B in relation to the infringement of S's proprietary rights). Alternatively, K may assert an unjustified enrichment claim: see VII.-3:101 (Enrichment) paragraph (1)(c), VII.-3:102 (Disadvantage) paragraph (1)(c) and VII.-4:101 (Instances of attribution) paragraph (c). Neither this Book (VII.-7:101) nor Book VI (see VI.-1:103 (Scope of application) paragraph (d)) prevent the concurrence of the claims under the rules on non-contractual liability for damage or under the rules on unjustified enrichment.

Illustration 6

A partner in a firm honours a bill of exchange which is a partnership debt. The partner has a right of recourse against the other partners on the basis that she has discharged more than her share of the solidary debt owed by the partners to the creditor: see III.-4:107 (Recourse between solidary debtors).

VII.-7:102: Concurrent obligations

(1) Where the disadvantaged person has both:

(a) a right under this Book to the reversal of an unjustified enrichment; and

(b) (i) a right to reparation for the disadvantage (whether against the enriched person or a third party); or

(ii) a right to recover under other rules of private law as a result of the unjustified enrichment,

the satisfaction of one of the rights reduces the other right by the same amount.

(2) The same applies where a person uses an asset of the disadvantaged person so that it accrues to another and under this Book:

(a) the user is liable to the disadvantaged person in respect of the use of the asset; and

(b) the recipient is liable to the disadvantaged person in respect of the increase in assets.

COMMENTS

General. The function of this provision is to prevent double recovery in a range of cases. These are firstly where the disadvantaged person has an enrichment claim and also another private law claim (against the same or a different person) which ought to be regarded as alternative (paragraph (1)). Such private law claims may take the form of a right to compensation or other reparation for damage caused arising out of the same disadvantage giving rise to the enrichment claim or a right of recovery which, like the enrichment claim, serves to reverse an enrichment. The second instance is where the disadvantaged person has enrichment claims against several enriched persons, but in respect of the same disadvantage (paragraph (2)).

Claims with different bases. In so far as an enrichment claim and a claim for reparation relate to the same disadvantage, any discharge of one claim also goes towards the discharge of the other. For example, where E has made use of D's asset, D may claim compensation for the deprivation of the property and will also have an enrichment claim based on a notional fee for the hire of the asset. D cannot demand payment of both sums since if D had the use (the basic point of reference for the loss in the reparation claim) D could not at the same time have hired the asset out to another (the basic point of reference for determining the quantum of liability for the enrichment claim: see VII.-5:102 (Non-transferable enrichment) paragraph (1) and VII.-5:103 (Monetary value of an enrichment; saving)). To have the benefit of both claims would involve a contradiction.

Claims against different persons. Paragraph (2) applies where a person has been enriched by making use of an asset of the disadvantaged person in such a manner that the asset has vested in another, who is correspondingly enriched by the increase in assets. In the usual case only one of the two claims will be meaningful for the disadvantaged person. If the recipient is a good faith acquirer who has given value for the enrichment, the enrichment will be justified by the property law rules on good faith acquisition or, in other cases, the recipient will have the benefit of the defence in VII.-6:102 (Juridical acts in good faith with third parties). In such a case only the claim against the user will yield benefit to the claimant. This paragraph therefore only applies in limited situations. Recovery on the basis of one claim reduces the other because the disadvantaged person cannot be permitted to recover both in respect of the claim against the transferor (enriched in making use of a right to dispose of an asset, for example) and the recipient (enriched in obtaining the asset). Otherwise the disadvantaged person would have the value of the asset twice over. The internal relationship between transferor and recipient will depend among other things on the terms of the contract or other juridical act between them.

VII.-7:103: Public law claims

This Book does not determine whether it applies to enrichments which a person or body obtains or confers in the exercise of public law functions.

COMMENTS

General. Among the Member States some legal systems have different sets of rules governing unjustified enrichment law for private law and public law cases and this Article respects that tradition. It leaves it to those public law rules to determine whether and in what fashion the rules of this Book should also extend to unjustified enrichment claims in the public law field or whether a completely different, specifically public law regime should govern. It is not the function of these private law rules to determine to what extent, if any, they are also apt for the public law sphere. This is in keeping with and broadens the general principle that these model rules are not intended to be used or used without modification or supplementation, in relation to rights and obligations of a public law nature: see I.-1:101 (Intended field of application) paragraph (2).

Contexts. Where specifically public law principles of unjustified enrichment law apply, these usually take the form of special modifications of the basic private law rules for public law cases. In addition, however, there may be special regimes for particular categories of public

law cases, such as, for example, for repayment of fees or tax to public authorities where less was due to the state or no sum was due at all, or for recovery of social security payments which were excessive or to which the recipient was not entitled. Such rules can take proper account of the complications specific to the public law field – for example, due to the fact that the legislation underpinning the authority to demand the sum is struck down under constitutional or administrative law or that the revenue raised has been factored into budgetary planning.

Scope. The priority of possible public law regimes of unjustified enrichment law envisaged by the Article relates to (a) claims between public law bodies, (b) claims by individuals against public law bodies (e.g. in respect of overpaid tax), and (c) claims by public law bodies against individuals (e.g. in respect of overpaid welfare benefits).

ANNEX 1: DEFINITIONS

Advanced electronic signature

See under “electronic signature”.

Arbitral tribunal

See “Court”.

Assets

“Assets” means anything of economic value, including property; rights having a monetary value; and goodwill.

Assignment

“Assignment”, in relation to a right, means the transfer of the right by one person, the “assignor”, to another, “the assignee”.

Authorisation

The “authorisation” of a representative is the granting or maintaining of the representative’s authority.

Authority

“Authority”, in relation to a representative acting for a principal, is the power to affect the principal’s legal position.

Avoidance

“Avoidance” of a juridical act or legal relationship is the process whereby a party or, as the case may be, a court invokes a ground of invalidity so as to make the act or relationship, which has been valid until that point, retrospectively ineffective from the beginning.

Barter, contract for

A contract for the “barter” of goods is a contract under which each party undertakes to transfer the ownership of goods, either immediately on conclusion of the contract or at some future time, in return for the transfer of ownership of other goods. Each party is considered to be the buyer with respect to the goods to be received and the seller with respect to the goods or assets to be transferred.

Benevolent intervention in another’s affairs

“Benevolent intervention in another’s affairs” is the process (sometimes known as negotiorum gestio) whereby a person, the intervener, acts with the predominant intention of benefiting another, the principal, but without being authorised or bound to do so.

Business

“Business” means any natural or legal person, irrespective of whether publicly or privately owned, who is acting for purposes relating to the person’s self-employed trade, work or profession, even if the person does not intend to make a profit in the course of the activity.

Capitalisation of interest

“Capitalisation of interest” is the process whereby accrued interest is added to capital.

Claim

A “claim” is a demand for something based on the assertion of a right.

Claimant

A “claimant” is a person who makes, or who has grounds for making, a claim.

Clause

“Clause” refers to a provision in a document. A clause, unlike a “term”, is always in textual form.

Co-debtorship for security purposes

A “co-debtorship for security purposes” is an obligation owed by two or more debtors in which one of the debtors, the security provider, assumes the obligation primarily for purposes of security towards the creditor.

Commercial agency

A “commercial agency” is the legal relationship arising from a contract under which one party, the commercial agent, agrees to act on a continuing basis as a self-employed intermediary to negotiate or to conclude contracts on behalf of another party, the principal, and the principal agrees to remunerate the agent for those activities.

Compensation

“Compensation” means reparation in money.

Condition

A “condition” is a provision which makes a legal relationship or effect depend on the occurrence or non-occurrence of an uncertain future event. A condition may be suspensive or resolutive.

Conduct

“Conduct” means voluntary behaviour of any kind, verbal or non-verbal: it includes a single act or a number of acts, behaviour of a negative or passive nature (such as accepting something without protest or not doing something) and behaviour of a continuing or intermittent nature (such as exercising control over something).

Construction, contract for

A contract for construction is a contract under which one party, the constructor, undertakes to construct something for another party, the client, or to materially alter an existing building or other immovable structure for a client.

Consumer

A “consumer” means any natural person who is acting primarily for purposes which are not related to his or her trade, business or profession.

Consumer contract for sale

A “consumer contract for sale” is a contract under which a business sells goods to a consumer.

Contract

A “contract” is an agreement which gives rise to, or is intended to give rise to, a binding legal relationship or which has, or is intended to have, some other legal effect. It is a bilateral or multilateral juridical act.

Contractual obligation

A “contractual obligation” is an obligation which arises from a contract, whether from an express term or an implied term or by operation of a rule of law imposing an obligation on a contracting party as such.

Contractual relationship

A “contractual relationship” is a legal relationship resulting from a contract.

Corporeal

“Corporeal”, in relation to property, means having a physical existence in solid, liquid or gaseous form.

Costs

“Costs” includes expenses.

Counter-performance

A “counter-performance” is a performance which is due in exchange for another performance.

Court

“Court” includes an arbitral tribunal.

Creditor

A “creditor” is a person who has a right to performance of an obligation, whether monetary or non-monetary, by another person, the debtor.

Damage

“Damage” means any type of detrimental effect. It includes loss and injury.

Damages

“Damages” means a sum of money to which a person may be entitled, or which a person may be awarded by a court, as compensation for some specified type of damage.

Debtor

A “debtor” is a person who has an obligation, whether monetary or non-monetary, to another person, the creditor.

Defence

A “defence” to a claim is a legal objection or a factual argument, other than a mere denial of an element which the claimant has to prove which, if well-founded, defeats the claim in whole or in part.

Delivery

“Delivery” to a person, for the purposes of any obligation to deliver corporeal movable property, means handing it over or otherwise transferring physical control over it to that person, or taking steps to ensure that that person can obtain physical control over it.

Dependent personal security

A “dependent personal security” is an obligation by a security provider which is assumed in favour of a creditor in order to secure a present or future obligation of the debtor owed to the creditor and performance of which is due only if, and to the extent that, performance of the latter obligation is due.

Design, contract for

A contract for design is a contract under which one party, the designer, undertakes to design for another party, the client, an immovable structure which is to be constructed by or on behalf of the client or a movable or incorporeal thing or service which is to be constructed or performed by or on behalf of the client.

Distribution contract

A “distribution contract” is a contract under which one party, the supplier, agrees to supply the other party, the distributor, with products on a continuing basis and the distributor agrees to purchase them, or to take and pay for them, and to supply them to others in the distributor’s name and on the distributor’s behalf.

Distributorship

A “distributorship” is the legal relationship arising from a distribution contract.

Divided obligation

An obligation owed by two or more debtors is a “divided obligation” when each debtor is bound to render only part of the performance and the creditor may require from each debtor only that debtor’s part.

Divided right

A right to performance held by two or more creditors is a “divided right” when the debtor owes each creditor only that creditor’s share and each creditor may require performance only of that creditor’s share.

Durable medium

A “durable medium” means any material on which information is stored so that it is accessible for future reference for a period of time adequate to the purposes of the information, and which allows the unchanged reproduction of this information.

Duty

A person has a “duty” to do something if the person is bound to do it or expected to do it according to an applicable normative standard of conduct. A duty may or may not be owed to a specific creditor. A duty is not necessarily an aspect of a legal relationship. There is not necessarily a sanction for breach of a duty. All obligations are duties, but not all duties are obligations.

Economic loss

See “Loss”.

Electronic

“Electronic” means relating to technology with electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

Electronic signature

An “electronic signature” means data in electronic form which are attached to, or logically associated with, other data and which serve as a method of authentication.

An “advanced electronic signature” means an electronic signature which is (a) uniquely linked to the signatory (b) capable of identifying the signatory (c) created using means which can be maintained under the signatory’s sole control; and (d) linked to the data to which it relates in such a manner that any subsequent change of the data is detectable.

Franchise

A “franchise” is the legal relationship arising from a contract under which one party, the franchisor, grants the other party, the franchisee, in exchange for remuneration, the right to conduct a business (franchise business) within the franchisor’s network for the purposes of supplying certain products on the franchisee's behalf and in the franchisee's name, and whereby the franchisee has the right and the obligation to use the franchisor’s trade name or trademark or other intellectual property rights, know-how and business method.

Fraudulent

A misrepresentation is fraudulent if it is made with knowledge or belief that it is false and is intended to induce the recipient to make a mistake to the recipient’s prejudice. A non-disclosure is fraudulent if it is intended to induce the person from whom the information is withheld to make a mistake to that person’s prejudice.

Fundamental non-performance

A non-performance of a contractual obligation is fundamental if (a) it substantially deprives the creditor of what the creditor was entitled to expect under the contract, as applied to the whole or relevant part of the performance, unless at the time of conclusion of the contract the debtor did not foresee and could not reasonably be expected to have foreseen that result or (b) it is intentional or reckless and gives the creditor reason to believe that the debtor’s future performance cannot be relied on.

Global security

A “global security” is a security which is assumed in order to secure all the debtor’s obligations towards the creditor or the debit balance of a current account or a security of a similar extent.

Good faith and fair dealing

“Good faith and fair dealing” refers to an objective standard of conduct. “Good faith” on its own may refer to a subjective mental attitude, often characterised by an absence of knowledge of something which, if known, would adversely affect the morality of what is done.

Goods

“Goods” means corporeal movables. It includes ships, vessels, hovercraft or aircraft, space objects, animals, liquids and gases. See also “movables”.

Gross negligence

There is “gross negligence” if a person is guilty of a profound failure to take such care as is self-evidently required in the circumstances.

Handwritten signature

A “handwritten signature” means the name of, or sign representing, a person written by that person’s own hand for the purpose of authentication.

Immovable property

“Immovable property” means land and anything so attached to land as not to be subject to change of place by usual human action.

Incorporeal

“Incorporeal”, in relation to property, means not having a physical existence in solid, liquid or gaseous form.

Indemnify

“Indemnify” means make such payment to a person as will ensure that that person suffers no loss.

Independent personal security

An “independent personal security” is an obligation by a security provider which is assumed in favour of a creditor for the purposes of security and which is expressly or impliedly declared not to depend upon another person’s obligation owed to the creditor.

Ineffective

“Ineffective” in relation to a contract or other juridical act means having no effect, whether that state of affairs is temporary or permanent, general or restricted.

Injured person

An “injured person” for the purposes of Book VI is a person who has suffered damage. The term is not, unless the context so requires, confined to a person who has suffered personal injury.

Insolvency administrator

An “insolvency administrator” is a person or body, including one appointed on an interim basis, authorised in an insolvency proceeding to administer the reorganisation or liquidation of the insolvent person’s assets or affairs.

Insolvency proceeding

An “insolvency proceeding” means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of a person who is, or who is believed to be, insolvent are subject to control or supervision by a court or other competent authority for the purpose of reorganisation or liquidation.

Intangible

See “Incorporeal”.

Interest

“Interest” means simple interest without any assumption that it will be capitalised from time to time.

Invalid

“Invalid” in relation to a juridical act or legal relationship means that the act or relationship is void or has been avoided.

Joint obligation

An obligation owed by two or more debtors is a “joint obligation” when all the debtors are bound to render the performance together and the creditor may require it only from all of them.

Joint right

A right to performance held by two or more creditors is a “joint right” when the debtor must perform to all the creditors and any creditor may require performance only for the benefit of all.

Juridical act

A “juridical act” is any statement or agreement or declaration of intention, whether express or implied from conduct, which has or is intended to have legal effect as such. It may be unilateral, bilateral or multilateral.

Keeper

A keeper, in relation to an animal, vehicle or substance, is the person who has the beneficial use or physical control of it for that person’s own benefit and who exercises the right to control it or its use.

Lease (of goods)

A “lease” of goods is the legal relationship arising from a contract under which one party, the lessor, undertakes to provide the other party, the lessee, with a temporary right of use of goods in exchange for rent. The rent may be in the form of money or other value.

Liable

A person is “liable” for damage if the person is under an obligation to make reparation for the damage.

Loss

“Loss” includes economic and non-economic loss. “Economic loss” includes loss of income or profit, burdens incurred and a reduction in the value of property. “Non-economic loss” includes pain and suffering and impairment of the quality of life.

Mandate

The “mandate” of a representative is the authorisation and instruction given by the principal, as modified by any subsequent direction.

Mandate contract

A mandate contract is a contract under which one party, the representative, has a mandate to conclude a contract between another party, the principal, and a third party or otherwise affect the legal position of the principal in relation to a third party.

Merger of debts

A “merger of debts” means that the attributes of debtor and creditor are united in the same person in the same capacity.

Merger clause

A “merger clause” is a clause in a written contract stating that the writing embodies all the terms of the contract.

Movables

“Movables” means corporeal and incorporeal property other than immovable property.

Must

“Must”, when used of a person (e.g. “the lessor must”), means that the person has an obligation unless otherwise indicated. “Must”, when used of a thing (e.g. “the goods must”), indicates a requirement.

Negligence

There is “negligence” if a person does not meet the standard of care which could reasonably be expected in the circumstances.

Non-economic loss

See “Loss”.

Non-performance

“Non-performance”, in relation to an obligation, means any failure to perform the obligation, whether or not excused. It includes delayed performance and defective performance.

Notice

“Notice” includes the communication of a promise, offer, acceptance or other juridical act.

Obligation

An obligation is a duty to perform which one party to a legal relationship, the debtor, owes to another party, the creditor.

Ownership

“Ownership” is the most absolute right a person, the owner, can have over property, including the exclusive right, so far as consistent with applicable laws or rights granted by the owner, to use, enjoy, modify, destroy, dispose of and recover the property.

Performance

“Performance”, in relation to an obligation, is the doing by the debtor of what is to be done under the obligation or the not doing by the debtor of what is not to be done.

Person

“Person” means a natural or legal person.

Prescription

“Prescription”, in relation to the right to performance of an obligation, is the legal effect whereby the lapse of a prescribed period of time entitles the debtor to refuse performance.

Presumption

A “presumption”, means that the existence of a known fact allows the deduction that an unknown fact should be held true, until the contrary is demonstrated.

Price

The “price” is what is due by the debtor under a monetary obligation, in exchange for something supplied or provided, expressed in a currency which the law recognises as such.

Processing, contract for

A contract for processing is a contract under which one party, the processor, undertakes to perform a service on an existing movable or incorporeal thing or to an immovable structure for another party, the client (except where the service is construction work on an existing building or other immovable structure).

Producer

“Producer” includes, in the case of something made, the maker or manufacturer; in the case of raw material, the person who abstracts or wins it; and in the case of something grown, bred or raised, the grower, breeder or raiser.

Property

“Property” means anything which can be owned: it may be movable or immovable, corporeal or incorporeal.

Proprietary security

A “proprietary security” covers security rights in all kinds of property, whether movable or immovable, corporeal or incorporeal.

Ranking

“Ranking”, in relation to claims, means putting the claims in an order of preference or subordination.

Ratify

“Ratify” means confirm with legal effect.

Reasonable

What is “reasonable” is to be objectively ascertained, having regard to the nature and purpose of what is being done, to the circumstances of the case and to any relevant usages and practices.

Recklessness

A person is “reckless” if the person knows of an obvious and serious risk of proceeding in a certain way but nonetheless voluntarily proceeds without caring whether or not the risk materialises.

Reparation

“Reparation” means compensation or another appropriate measure to reinstate the person suffering damage in the position that person would have been in had the damage not occurred.

Representative

A “representative” is a person who has authority to affect the legal position of another person, the principal, in relation to a third party by acting on behalf of the principal.

Requirement

A “requirement” is something which is needed before a particular result follows or a particular right can be exercised.

Resolutive

A condition is “resolutive” if it causes a legal relationship or effect to come to an end when the condition is satisfied.

Revocation

“Revocation”, means (a) in relation to a juridical act, its recall by a person or persons having the power to recall it, so that it no longer has effect and (b) in relation to something conferred or transferred, its recall, by a person or persons having power to recall it, so that it comes back or must be returned to the person who conferred it or transferred it.

Right

“Right”, depending on the context, may mean (a) the correlative of an obligation or liability (as in “a significant imbalance in the parties' rights and obligations arising under the contract”); (b) a proprietary right (such as the right of ownership); (c) a personality right (as in a right to respect for dignity, or a right to liberty and privacy); (d) a legally conferred power to bring about a particular result (as in “the right to avoid” a contract); (e) an entitlement to a particular remedy (as in a right to have performance of a contractual obligation judicially ordered) or (f) an entitlement to do or not to do something affecting another person’s legal position without exposure to adverse consequences (as in a “right to withhold performance of the reciprocal obligation”).

Sale, contract for

A contract for the “sale” of goods is a contract under which one party, the seller, undertakes to another party, the buyer, to transfer the ownership of the goods to the buyer, or to a third person, either immediately on conclusion of the contract or at some future time, and the buyer undertakes to pay the price.

Services, contract for

A contract for services is a contract under which one party, the service provider, undertakes to supply a service to the other party, the client.

Set-off

“Set-off” is the process by which a debtor may reduce the amount owed to the creditor by an amount owed to the debtor by the creditor.

Signature

“Signature” includes a handwritten signature, an electronic signature or an advanced electronic signature.

Solidary obligation

An obligation owed by two or more debtors is a “solidary obligation” when all the debtors are bound to render one and the same performance and the creditor may require it from any one of them until there has been full performance.

Solidary right

A right to performance held by two or more creditors is a “solidary right” when any of the creditors may require full performance from the debtor and the debtor may render performance to any of the creditors.

Standard terms

“Standard terms” are terms which have been formulated in advance for several transactions involving different parties, and which have not been individually negotiated by the parties.

Storage, contract for

A contract for storage is a contract under which one party, the storer, undertakes to store a movable or incorporeal thing for another party, the client.

Subrogation

“Subrogation” is the process by which a person who has made a payment or performance to another person acquires by operation of law that person’s rights against a third person.

Substitution

“Substitution” of a new debtor is the process whereby, with the agreement of the creditor, a third party is substituted for the debtor, the contract remaining in force.

Supply

To “supply” goods means to make them available to another person, whether by sale, gift, barter, lease or other means: to “supply” services means to provide them to another person, whether or not for a price. Unless otherwise stated, “supply” covers the supply of goods and services.

Suspensive

A condition is “suspensive” if it prevents a legal relationship or effect from coming into existence until the condition is satisfied.

Term

“Term” means any provision, express or implied, of a contract or other juridical act, of a law, of a court order or of a legally binding usage or practice: it includes a condition.

Termination

“Termination”, in relation to an existing right, obligation or legal relationship, means bringing it to an end with prospective effect except in so far as otherwise provided.

Textual form

In “textual form”, in relation to a statement, means expressed in alphabetical or other intelligible characters by means of any support which permits reading, recording of the information contained in the statement and its reproduction in tangible form.

Transfer of contractual position

“Transfer of contractual position” is the process whereby, with the agreement of all three parties, a new party replaces an existing party to a contract, taking over the rights, obligations and entire contractual position of that party.

Treatment, contract for

A contract for treatment is a contract under which one party, the treatment provider, undertakes to provide medical treatment for another party, the patient, or to provide any other service in order to change the physical or mental condition of a person.

Unjustified enrichment

An “unjustified enrichment” is an enrichment which is not legally justified, with the result that, if it is obtained by one person and is attributable to another’s disadvantage, the first person may, subject to legal rules and restrictions, be obliged to that other to reverse the enrichment.

Valid

“Valid”, in relation to a juridical act or legal relationship, means that the act or relationship is not void and has not been avoided.

Void

“Void”, in relation to a juridical act or legal relationship, means that the act or relationship is automatically of no effect from the beginning.

Voidable

“Voidable”, in relation to a juridical act or legal relationship, means that the act or relationship is subject to a defect which renders it liable to be avoided and hence rendered retrospectively of no effect.

Withdraw

A right to “withdraw” from a contract or other juridical act is a right to terminate the legal relationship arising from the contract or other juridical act, without having to give any reason for so doing and without incurring any liability for non-performance of the obligations arising from that contract or juridical act. The right is exercisable only within a limited period (in these rules, normally 14 days) and is designed to give the entitled party (normally a consumer) an additional time for reflection. The restitutionary and other effects of exercising the right are determined by the rules regulating it.

Withholding performance

“Withholding performance”, as a remedy for non-performance of a contractual obligation, means that one party to a contract may decline to render due counter-performance until the other party has tendered performance or has performed.

Writing

In “writing” means in textual form, on paper or another durable medium and in directly legible characters.

ANNEX 2: COMPUTATION OF TIME

- (1) Subject to the following provisions of this Annex:
 - (a) a period expressed in hours starts at the beginning of the first hour and ends with the expiry of the last hour of the period;
 - (b) a period expressed in days starts at the beginning of the first hour of the first day and ends with the expiry of the last hour of the last day of the period;
 - (c) a period expressed in weeks, months or years starts at the beginning of the first hour of the first day of the period, and ends with the expiry of the last hour of whichever day in the last week, month or year is the same day of the week, or falls on the same date, as the day from which the period runs. If, in a period expressed in months or in years, the day on which it should expire does not occur in the last month, the period ends with the expiry of the last hour of the last day of that month;
 - (d) if a period includes part of a month, the month is considered to have thirty days for the purpose of calculating the length of the part.
- (2) Where a period is to be calculated from a specified event or action, then:
 - (a) if the period is expressed in hours, the hour during which the event occurs or the action takes place is not considered to fall within the period in question; and
 - (b) if the period is expressed in days, weeks, months or years, the day during which the event occurs or the action takes place is not considered to fall within the period in question.
- (3) Where a period is to be calculated from a specified time, then:
 - (a) if the period is expressed in hours, the first hour of the period is considered to begin at the specified time; and
 - (b) if the period is expressed in days, weeks, months or years, the day during which the specified time arrives is not considered to fall within the period in question.
- (4) The periods concerned include Saturdays, Sundays and public holidays, save where these are expressly excepted or where the periods are expressed in working days.
- (5) Where the last day of a period expressed otherwise than in hours is a Saturday, Sunday or public holiday at the place where a prescribed act is to be done, the period ends with the expiry of the last hour of the following working day. This provision does not apply to periods calculated retroactively from a given date or event.
- (6) Any period of two days or more is regarded as including at least two working days.
- (7) Where a person sends another person a written document which sets a period of time within which the addressee has to reply or take other action but does not state when the

period is to begin, then, in the absence of indications to the contrary, the period is calculated from the date stated as the date of the document or, if no date is stated, from the moment the document reaches the addressee.

(8) In this Annex;

“public holiday” with reference to a member state, or part of a member state, of the European Union means any day designated as such for that state or part in a list published in the official journal;

“working days” means all days other than Saturdays, Sundays and public holidays.