

Article 4:108: Threats

A party may avoid a contract when it has been led to conclude it by the other party's imminent and serious threat of an act:

(a) which is wrongful in itself, or

(b) which it is wrongful to use as a means to obtain the conclusion of the contract,

unless in the circumstances the first party had a reasonable alternative.

COMMENT

A. Threats Wrongful in Themselves

The notion of freedom of contract suggests that party should only be bound by actions which were both voluntary, in the sense that the party was aware of what it was doing, and free, in the sense that it had some choice. In practice the notion of freedom has to be tempered. On the one hand, an action which was literally forced by the other party - the person who is made to sign by the other grabbing his 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 the Principles, see Articles 2:101 and 2:102. On the other hand, there are frequent occasions on which the choices facing a party are constrained by his circumstances and it may feel it "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.

The law can insist that a party should not be constrained by the actions of the other party when those actions are unjustifiable. First, 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 if it did not consent. Article 4:108(a) rests on this principle.

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.

B. 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 it makes 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 B to build a road across A's farmland at a fixed price. A finds that the land is much wetter than either party had realised and A will literally be bankrupt before it has performed the contract at the original price. A informs B of this and B agrees to pay an increased price. Although B had no real choice, it cannot avoid the agreement to pay the increased price.

C. Threats Which It is Wrongful to Use to Obtain the Promise

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.

D. 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: E employs 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.

E. No Reasonable Alternative

Relief will not be given if a party gave in to a threat when it had a perfectly good alternative - e.g. it 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, that suggests that the threat was not the real reason for the threatened party agreeing to the demand. The burden of proving that the party had a reasonable alternative rests on the party which made the threat.

F. Remedies

The party subjected to the threat may avoid the contract, provided it gives notice within a reasonable time, see Article 4:113. It may also claim damages, see Article 4:117.

G. No Exclusion of Remedies

Threats are a form of wrongful behaviour and therefore the remedies cannot be excluded or restricted by contrary agreement, see Article 4:118(1).

NOTES

All the systems recognise that a contract which is procured by one party making an illegitimate threat against the other may be avoided by the latter. For example, AUSTRIAN ABGB § 870 (if illegal threat and well-founded fear); NORDIC Contract Acts §§ 28, 29; DUTCH BW art.3:44; FRENCH, BELGIAN and LUXEMBOURG CCs art.1112 (avoidance if *violence* produces in the victim a fear of present and considerable harm to his person or property); GERMAN BGB § 123(1) (party may avoid a contract into which he was induced by illicit threats); GREEK CC art. 151; ITALIAN CC art.1434; PORTUGUESE CC arts 246 and 256; SPANISH CC arts. 1267 AND 1268. For ENGLISH law (“duress”) see *Chitty* §§ 7-001 - 023; for IRISH law, *Clark* 260-268; for SCOTS law (“force and fear”) see *McBryde* 250-255. There are some variations in the conditions under which relief will be granted.

1. Threat must have influenced the party seeking to avoid.

In most systems the test is a subjective one: the party seeking to avoid must show that he was influenced by the threat: GERMAN law: BGH 22 January 1964, NJW 1964, 811 (though the threatening party must have acted with the intention of obtaining the other party's consent: *Larenz*, § 20 IV b, p.401); NORDIC law (*Telaranta*, Sopsimusoikeus 320); PORTUGUESE CC art. 255. In ENGLISH law the threat must have influenced the party seeking to avoid the contract; thus a payment which the threatening party had demanded and which was not due, but which was paid not because of the threat but to save trouble ("voluntarily to close the transaction"), is not recoverable: *Maskell v. Horner* [1915] 3 K.B. 106, C.A. However the burden of proving that the threat did not influence the threatened party is a heavy one (*Chitty* § 7-021). In cases of physical duress it suffices that the threat had some effect on the victim's consent; the threat need not be the only or even the main reason he agreed to the contract. See *Barton v. Armstrong* [1976] A.C. 104, P.C. It does not appear that the threat must have been one which would have influenced a reasonable person.

Under FRENCH and LUXEMBOURG CCs art.1112 it seems that the test is not purely subjective: the threat must have been one that would influence a reasonable person of the same age, sex and condition (and see also ITALIAN CC art.1435). But it is said that the courts in France take a subjective approach (e.g. Com. 28 May 1991, D.1992.166, note P. Morvan; *Nicholas* 106, citing Req. 27 January 1919, S. 1920.1.198; Req. 17 November 1925, S. 1926.1 121.) AUSTRIAN law also seems to take a subjective approach in practice; the fear must be "well-founded" but the physical and mental state of the threatened person is taken into account as well as the gravity and probability of danger.

DUTCH law takes an objective approach in that the threat must be one that would have influenced a reasonable person BW art.3:44(1).

Article 4:108 applies whenever the threat was imminent and serious and actually led to the conclusion of the contract which the party threatened is seeking to avoid.

2. The threat may be of physical or financial harm

The continental systems do not limit relief to cases of threats of physical harm, but also include threats of causing financial or moral harm provided that the threat is illicit: for example FRENCH, BELGIAN and LUXEMBOURG CCs art.1112 ("*la crainte d'exposer sa personne ou sa fortune à un mal*"); PORTUGUESE CC arts 246 (contract made under physical threat null) and 256 (if under moral threat, avoidable); in GERMAN law, BGH 25 June 1965, LM § 123, no.32 (threat not to pay bill of exchange in order to induce other party to sell real estate); GREEK CC art.151; ITALIAN CC art.1435; THE NETHERLANDS, HR 27 March 1992, NJ 1992, 377, HR 29 May 1964, NJ 1965, 104. In ENGLISH law it at one time seemed that the threat had to be one of physical violence or of wrongful seizure of property, but it is now recognised that a contract may be avoided in cases of "economic duress": that is, where the contract was made as the result of a threatened wrong, such as a breach of contract, and the party seeking relief gave in because he would suffer serious losses if

the threat was carried out and he had no real alternative: e.g. he could not effectively protect himself by taking legal action. See *North Ocean Shipping Co Ltd v. Hyundai Construction Co Ltd, The Atlantic Baron* [1979] Q.B. 705, Q.B., which is the source of Illustration 3. Economic duress has not yet been recognised in IRISH or SCOTS law. Article 4:108 applies to all kinds of wrongful threats.

3. The threat must be illegitimate but need not be one of an act itself unlawful.

The threat must be illegitimate, but most systems recognise that it may be illegitimate to use a threat of something itself not unlawful to extract a payment or promise: e.g. in FRENCH law, to threaten abusive use of a legal procedure such as a *saisie*: Civ.3, 17 January 1984, B.III, no.13; similarly LUXEMBOURG law, Cour, 10 May 1929, Pasicrisie 11, p.459; in BELGIAN and GERMAN law, to threaten criminal proceedings against a relative of the other party, see respectively CA Brussels, 7 February 1980, Pas. 1980, II, 55, JT 1980, 282; OLG Karlsruhe, 11 January 1991, VersR 1992, 703; PORTUGUESE CC art 255. In English law, a contract made in similar circumstances was held to be voidable (*Williams v. Bayley* (1866) L.R. 1 H.L. 200, H.L.). In *Universe Tankships of Monrovia Ltd v. ITWF* [1983] 1 A.C. 366, H.L., Lord Scarman recognised that a threat to do something itself legal for an improper purpose (“blackmail”) would amount to duress, but it is doubtful whether threats of lawful action which do not amount to a crime would suffice. In *CTN Cash & Carry Ltd v. Gallaher Ltd* [1994] 4 All E.R. 714 the Court of Appeal has said that it will be slow to accept cases of “lawful act duress”. Similarly, in AUSTRIAN law the threat must be “illegal”, which may mean that the threat must amount to the crime of extortion (StGB § 144) or the misdemeanour of compulsion (StGB § 105). Threats of lawful actions may also be illegitimate under NORDIC Contract Acts § 29.

4. A demand for extra payment in exchange for performing a contractual obligation will not necessarily be treated as wrongful.

Some systems recognise explicitly that a party who is faced with unforeseeable expense in performing may state truthfully that he will be unable to perform unless paid extra and that, if the other party promises the extra payment, the promise will not be avoidable on the ground of duress. See on DANISH law *Gomard*, Kontraktret 155. Similarly in ENGLISH law it has been argued that there is no duress if the party claiming that he cannot perform is merely stating the inevitable (e.g. that he will go bankrupt if he is not paid extra) or perhaps if the threatening party acts in good faith in demanding more (see the discussion in *Burrows* 179-182). Under the Principles a truthful statement to the effect that the party will be unable to perform unless paid extra will not amount to a threat, see Comment B.

5. Threat made by a third party

On this point there are considerable differences between the systems. In ENGLISH law a threat made by a third party only gives a right of avoidance if the other party had actual or constructive notice of it, or the person making the threat was his agent. AUSTRIAN ABGB § 875 and DUTCH BW art. 3:44(5) are to similar effect. In contrast, FRENCH, BELGIAN and LUXEMBOURG CCs art. 1111 explicitly covers the case of a threat made by a third party, and so do ITALIAN CC art. 1434 and PORTUGUESE CC art. 256. The latter requires that, in the case of a threat by a third

person, the harm threatened be serious and the victim's fear justified, whereas these conditions do not apply to a threat made by the other party himself. GERMAN law also covers threats made by third parties and it does not matter that the other party to the contract acted in good faith (BGH 6 July 1966, NJW 1966, 2399, 2401; contrast to BGB § 123(2) which explicitly states the opposite rule for fraud). GREEK CC arts. 150 and 153 are still more liberal: the victim of a threat by a third party has an unqualified right to avoid the contract but the promisee may, at the judge's discretion, be compensated for his reliance loss if he neither knew or ought to have known of the threat (see *Maridakis* 195, 196).

NORDIC law takes an intermediate position. Under Contracts Act § 28, the promisor who was threatened with imminent violence may avoid the contract even if the threat was by a third party; other threats (§ 29) are only a defence against a promisee who knew or ought to have known of them.

The Principles adopt the rule that if a threat is made by a third person for whom a party is responsible, or if a party knew or ought to have known of a threat made to the other party by some other third person, the position will be as if the first party had made the threat itself. See notes to Article 4:111 below.

On duress generally see *Kötz*, European Contract 209-213.

Article 4:109: Excessive Benefit or Unfair Advantage

- (1) *A party may avoid a contract if, at the time of the conclusion of the contract:*
 - (a) *it 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 ought to have known of this and, given the circumstances and purpose of the contract, took advantage of the first party's situation in a way which was grossly unfair or took an excessive benefit.*
- (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 followed.*
- (3) *A court may similarly adapt the contract upon the request of a party receiving notice of avoidance for excessive benefit or unfair advantage, provided that this party informs the party which gave the notice promptly after receiving it and before that party has acted in reliance on it.*

COMMENT

A. Pacta Sunt Servanda and Unfair Advantage-taking

Contract law does not in general insist that bargains be fair in the sense that the performances exchanged be of what others might call equal value. It is commonly held that the parties are the best judges of the relative values to be exchanged. However many systems refuse to uphold contracts which involve an obviously gross disparity in the value of the two performances when this appears to be the result of some bargaining weakness on one side and conscious advantage-taking on the other.

Article 4:109 adopts the principle that a contract which gives one party excessive advantage and which involved unfair advantage taking 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 to him, when there is no apparent reason why he did not look after his own interests better when agreeing. Relief should only be available when the party can point to some weakness, disability or need on his part to explain what happened. This may include the fact that he had a confidential relationship with the other party and was relying on the other to advise him, if this meant that he was not exercising his own independent judgement.

C. Knowledge of Party Obtaining Advantage

It would also create too much uncertainty to upset contracts which are one-sided when there was no reason for the party who gains the advantage to know that the other party was in a weaker position. It is only when he should know that the other party is not in a position to safeguard his own interests that the stronger party should have to have regard to the weaker party's interests.

D. Excessive Advantage

The article applies where the advantage 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 it 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: as 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. See Illustration 9 to Article 4:103.

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 under Article 4:116, since it allows the substitution of a fair term.

Conversely it may not be fair to the party which gained the advantage simply to avoid the whole contract; that could result in unfairness the other way. So the court has power to modify 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 under Article 4:117; these are limited to the amount by which it is worse off compared to its position before the contract was made (the "reliance interest").

H. Remedies Cannot be Excluded

Since it is unconscionable to take advantage of the other party to gain an excessive advantage, the remedies for excessive advantage cannot be excluded or restricted by agreement: see Article 4:118(1).

NOTES

All the systems in some circumstances permit avoidance of a contract which has been obtained by unfair means, but some allow relief simply because the substance of the contract is unfair.. Most continental systems have fairly broad rules permitting avoidance where one party has deliberately taken advantage of the other party's need or circumstances to obtain a very one-sided contract (see note 1), but some do not insist on the plaintiff having been in a vulnerable position (see note 2) or grant relief simply on the basis of great disproportion in value (lesion; see note 3). The common law and Scots law seem to give relief primarily in cases of abuse of a special relationship between the parties, and in the absence of such a relationship to grant it only under very limited conditions. Many systems have particular rules governing loans or consumer credit transactions.

1. Taking advantage of a vulnerable party.

Many systems give relief when one party has taken advantage of the other's particular circumstances to obtain an unfair contract. Thus FRENCH jurisprudence, although not wholly settled, treats exploitation of a party's economic necessity or other circumstances as a form of *violençe*: Soc.5 July 1965, B.IV no.545; Civ.1, 24 May 1989, B.I, no.212; compare in BELGIUM, CA Brussels 7 February 1964, Pas. 1965 II 70. Otherwise relief is only given for error, threat or fraud and, in very limited circumstances, for *lésion* (see below). Belgian doctrine and case law gives relief for abuse of right when it gives rise to a disproportionate transaction, under the doctrine of qualified lesion, whereas relief for lesion without abuse of right (see Note 3 below) is rare: see *Kruithof & Bocken*, TPR 1994 p. 394 No. 149 and Cass. 21 September 1961, Pas. 1962 I 92; Cass. 25 November 1977, Arr.Cass. 1978, 343; Cass. 29 April 1993, JT 1994, 294. The new art.1118 of the LUXEMBOURG CC gives a remedy for abuse of circumstances generally. The DUTCH BW similarly allows annulment of a juridical act where there has been threat, fraud or abuse of circumstances; the latter is defined as being induced to execute a juridical act as a result of special circumstances such as state of necessity, dependency, wantonness, abnormal mental condition or inexperience (art.3:44(4)). In NORDIC law, Contracts Act § 31 applies where one party has taken advantage of the other's special circumstances to acquire a disproportionate benefit; but there is also the possibility of the setting aside or adjustment of a unfair contract under § 36 without the need for special circumstances, see below. SCOTTISH law permits "facility and circumvention" when advantage was taken a plaintiff who was "facile"- for example, elderly or unwell.

In ENGLISH and IRISH law, relief may be given under two separate rules, each involving the exploitation of a plaintiff who is particularly vulnerable. The first is the doctrine of undue influence where one party has exercised, or is in a position to exercise, a high degree of control over the other. Relief may be available if it is shown either that one party exercised such a degree of domination and control over the other that the latter's independence of mind was undermined ("actual" undue influence: see *Chitty* § 7-028), or that the parties were in a confidential relationship. In the latter situation, if the weaker party enters into a manifestly disadvantageous contract with the stronger, a presumption arises that undue influence has been used. Some relationships (e.g. doctor and patient) are treated as always giving rise to a confidential

relationship; in other cases such a relationship may be proved (e.g. between husband and wife, see *Barclays Bank v. O'Brien* [1994] 1 A.C. 180, H.L. or bank manager and client, see *Lloyd's Bank Ltd v. Bundy* [1975] Q.B. 326, C.A. For Ireland, see *Bank of Ireland v. Smyth* [1993] 2 I.R. 102, affirmed on other grounds [1996] 1 ILRM 241; Annual Review of Irish Law 1993, 194.). The doctrine of undue influence is also known in SCOTLAND but the presumption of undue influence is not used and the influence must always be proved.

Secondly, the doctrine of unconscionable bargains states that if a party takes deliberate advantage of the other party's poverty and ignorance to buy property from the poor and ignorant person at much less than its true value, the weaker party may have the contract set aside (see *Fry v. Lane* (1888) 40 Ch.D. 312). The doctrine is old and not much used in England, though see *Boustany v. Piggott* [1993] E.G.C.S. 85, P.C., and the parallel rule in a case where a party, though not completely incapable of transacting, is suffering from some mental disability, see *Hart v. O'Connor* [1985] A.C. 1000, P.C. In Ireland the doctrine of unconscionability is used more frequently, e.g. *Grealish v. Murphy* [1946] IR 35 (HC), *Lyndon v. Coyne* (1946) 12 Ir.Jur. Rep. 64 (H.Ct.); *JH v. WJH* (unrep., 20 Dec. 1979, (H.Ct.)). Common law does not recognise any general doctrine of abuse of circumstances; relief in this kind of case is limited to cases of extortionate credit bargains (Consumer Credit Act 1974, ss. 137, 138) and salvage on the high seas (e.g. *The Port Caledonia and The Anna* [1903] P. 184).

Other systems seem to follow the notion of limiting relief to abuse of circumstances but give relief in more limited conditions. Thus ITALIAN law recognises that a contract made in circumstances of economic distress may be avoided but only if the performances are disproportionate in a ratio of greater than 1:2 (art.1448); or if the contract was made in a situation of danger and on iniquitous terms (art. 1447). PORTUGUESE CC arts 282 and 283 apply when the victim is inexperienced, imprudent or in a state of necessity, but it may be possible to interpret the provisions to cover all the situations referred to in Article 4:109, see *Eiró*, Do negocio usuario 45

2. Excessive advantage-taking rather than protection of particularly vulnerable plaintiffs.

In contrast there are systems in which the position of the plaintiff is not so important as the disparity between the obligations. The AUSTRIAN ABGB § 879, GERMAN BGB § 138(2) and GREEK CC Arts. 178 and 179 treat contracts which involve a gross disparity as contrary to good morals and therefore voidable. The cases concentrate on the excessive disparity rather than the particular vulnerabilities of the weaker party; the most important group of cases in German law are those dealing with consumer credit and hire-purchase agreements, which are void if the overall interest rate to be paid is deemed to be excessive, e.g. if it is 100% above the average rate (BGH 24 March 1988, BGHZ 104, 102, 105; BGH 13 March 1990, BGHZ 110, 336, 338.; see Palandt § 138 no.25 ff.. ABGB § 879(4) and BGB § 138(2), which refer to exploitation of the needs, inexperience, lack of judgement or weakness of will of the

losing party, are consequently rarely applied. The vulnerability of the weaker party is, however, important in cases of sureties who have given guarantees without the means to meet their possible liability (e.g. BVerfG 19 October 1993, NJW 1994, 36; BGH 24 February 1994, NJW 1994, 1278). In NORDIC law a contract which is substantively unfair may be set aside or adjusted under Contracts Act § 36 without the need to show that the gaining party took advantage of the other's circumstances.

3. *Lesion*

FRENCH and BELGIAN CCs art.1118 state that a contract for the sale of immovables may be set aside on the ground of *lésion* only in certain situations, principally if the price paid for an immovable is less than 5/12ths of the value (arts. 1674-1685), in the case of *partage* (division between heirs, CC arts 887 and 1079) or where the contract is with a minor or someone who is incapable (art 1305).

LUXEMBOURG law is the same except when undue advantage has been taken, see Note 1 above. AUSTRIAN ABGB §§ 934, 935 recognise *laesio enormis* as a ground for avoidance or adaptation of a contract where a party to a synallagmatic contract receives a counter-performance of less than 50% of the value of his own performance, judged by the relative values at the time the contract was made. The rule cannot be excluded by contrary stipulation and has become an important remedy in consumer protection..

The Principles follow what seems to be the majority position in requiring one party to have taken advantage of the other's special weakness to obtain an unfair contract, rather than giving relief simply on the basis of a disproportion in values between the performances.

4. *Deliberate exploitation*

Apart from the cases of lesion described in the last note, the majority of systems agree that it is only when one party has deliberately taken advantage of the other that relief will be given. Thus in ENGLISH law it has been said that relief on the grounds of mental incapacity or unconscionability can be given only where one party consciously took advantage of the other's weakness: *Hart v. O'Connor* [1985] A.C. 1000, P.C. But this is not required in IRISH law. DUTCH BW art.3:44 applies when the gaining party ought to have known of the other's weakness. For PORTUGUESE law see *Eiró* 51, 57. In practice courts in the various systems will infer advantage-taking from the objective facts of gross disparity: e.g. in GERMAN law BGH 14 June 1984, NJW 1984, 2292; BGH 10 July 1986, BGHZ 98, 174, 178; in English law, the presumption of undue influence which arises from a manifestly disadvantageous transaction, above, and see *Crédit Lyonnais Bank Nederland NV v. Burch* [1997] 3 All E.R. 144, C.A.

5. *The contract must be excessively one-sided.*

In all systems the transaction must be excessively one-sided or unfair before relief will be given. In some systems it seems that the unfairness must be measured by an objective criteria such as the market price: e.g. GREEK law, AP 281/1968, NoB 1968.815; NORDIC law, Contracts Act § 31 ("obviously disproportionate", see

Telaranta 336-337), and in ENGLISH law the transaction must be manifestly disadvantageous for the presumption of undue influence to arise, or involve a sale at undervalue for the contract to be unconscionable. But “objective unfairness” is not always required: e.g. in DUTCH law, if the old widow did not want to sell her house it is no excuse to say that she received a fair price, HR 27 March 1992, NJ 1992, 377. See also HR 29 May 1964, NJ 1965, 104; in English law in cases of actual undue influence the weaker party may set aside the transaction without showing that it was manifestly disadvantageous: *CIBC Mortgages Ltd v. Pitt* [1994] 1 A.C. 200, H.L.

6. Adaptation of the contract

Although the traditional remedy granted is simply avoidance of the contract, some systems permit the court to adapt the contract to remove the disproportion: e.g. FRENCH CC art. 1681; LUXEMBOURG CC art.1118 (at the request of the disadvantaged party only); similarly, DUTCH BW art. 3:54; AUSTRIAN ABGB § 935 (*laesio enormis*); NORDIC Contract Acts § 36 and, at least in Denmark, § 31 (see *Lynge Andersen* 224); PORTUGUESE CC art 283 (1) and (2). BELGIAN case law applies reduction as a sanction for abuse of right, see Cass. 18 February 1988, RW 1988-89, 1226, Arr. Cass. No. 375. Additionally, many systems allow the court to reduce excessive interest rates on loans, e.g. Belgian CC art. 1907 (3); Luxembourg CC art. 1907-1; U.K. Consumer Credit Act 1974, s.139.

The idea that a party who has received notice of avoidance may maintain the contract by offering an amendment which would remove the injustice is found in ITALIAN law (CC. art. 1450).

Article 4:110: Unfair Terms not Individually Negotiated

- (1) *A party may avoid a term which has not been individually negotiated if, contrary to the requirements of good faith and fair dealing, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of that party, taking into account the nature of the performance to be rendered under the contract, all the other terms of the contract and the circumstances at the time the contract was concluded.*
- (2) *This Article does not apply to:*
- (a) *a term which defines the main subject matter of the contract, provided the term is in plain and intelligible language; or to*
 - (b) *the adequacy in value of one party's obligations compared to the value of the obligations of the other party.*

COMMENT

A. Scope of Application

This provision extends the scope of application of the general clause of the EC Council Directive 93/13 on Unfair Terms in Consumer Contracts (1993) to contracts between private persons and to commercial contracts.

B. No Black List

Unlike the Directive, the Principles contain no list of clauses deemed to be unfair. In contracts between professionals, a listing of contract terms as being *per se* unfair, because of the diversity of commercial contracts, is generally held to be all but impossible.

The absence of a list does not prevent judges and arbitrators from finding inspiration in the list in the Annex to the EC Directive when they are applying the general clause of Article 6.110.

The Annex to the EC Directive mentions the following clauses:

'1. Terms which have the object or effect of:

(a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;

(b) inappropriately excluding or limiting the legal rights of the consumer *vis-à-vis* the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;

- (c) making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realisation depends on his own will alone;
- (d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;
- (e) requiring the consumer who fails to fulfill his obligation to pay a disproportionately high sum in compensation;
- (f) authorizing the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;
- (g) enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so;
- (h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express this desire not to extend the contract is unreasonably early;
- (i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
- (j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
- (k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;
- (l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
- (m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;
- (n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;
- (o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
- (p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;
- (q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

2. Scope of subparagraphs (g), (j) and (k)

- (a) Subparagraph (g) is without hindrance to terms by which a supplier of financial services reserved the right to terminate unilaterally a contract of indeterminate duration without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof immediately.
- (b) Subparagraph (j) is without hindrance to terms under which a supplier of financial services reserves the right to alter the rate of interest payable by the consumer or due to the latter, 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 other contracting party or parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately.

Subparagraph (j) is also without hindrance to terms under which a seller or supplier reserves the right to alter unilaterally the conditions of a contract of indeterminate duration, provided that he is required to inform the consumer with reasonable notice and that the consumer is free to dissolve the contract.

- (c) Subparagraphs (g), (j) and (l) do not apply to
- 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 that the seller or supplier does not control;
 - contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in a foreign currency.
- (d) Subparagraph (l) is without hindrance to price-indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.

Courts and arbitrators may find this list useful especially when they are dealing with commercial contracts between a small and a large business.

Illustration 1: A runs a small petrol station. He obtains his oil products from a large oil company. In considering whether or not one or more of the contract terms imposed upon A by the oil company cause a significant imbalance, regard may be had, among others, to the list in the EC Council Directive Annex. Thus a set-off clause (subparagraph (b)) and a penalty clause (subparagraph (e)) in the contract terms may be deemed voidable.

C. Voidability

Since the Principles do not include a list and the general clause in itself is open, it will usually, in the absence of precedents, not be possible to say straightaway that a clause is unfair. In derogation of the EC Directive, the Principles therefore do not impose the sanction that an unfair clause be not binding. Rather they impose the sanction of voidability, which is more in line with the other provisions of this Chapter. There is

no material difference to the Directive, however, since avoidance under the Principles does not require the interference of a judge or arbitrator.

D. Main Subject Matter

What judges and arbitrators may not do is to judge the relation between the price and the main subject matter. Article 6:110 does not reintroduce the *iustum pretium* doctrine of canon law. The second paragraph aims to prevent this.

The second paragraph should be interpreted strictly. Terms which allow a party to raise the price are covered by the first paragraph.

Illustration 2: A car dealer sells an expensive car, which is so popular that there is a six month waiting list. The dealer sells the car for the price “as listed by the manufacturer at the time of delivery”. Although the term relates to the price of the car, it is to be considered a term in the sense of paragraph (1).

E. Unfair Terms and Grossly Unfair Advantage

Articles 4:109 and 4:110 at first sight have something in common. However, they deal with different situations. Article 4:109 deals with the case where A takes advantage of B's difficult position. The provision covers both the situation where the price or the other essentials of the contract, or the general conditions are excessive in one way or another. Article 4:110 deals only with what mainly are general conditions, and not with the price. It covers a very frequent situation, where one of the parties has drafted the contract terms in advance.

F. Individually Negotiated

A term has been “individually negotiated” when it has been the explicit subject of negotiations between the parties. Such negotiations may result in a draft term proposed by the other party being amended or struck out. They may also result in the term remaining unchanged.

Whether or not a term should be deemed individually negotiated will depend upon the circumstances of the case. A term in general conditions of contract which is used in a number of contracts will usually be considered not individually negotiated. A hand-written term in a unique contract will be considered to be individually negotiated. However, depending upon the circumstances this may be different in a specific case.

G. Significant Imbalance

A significant imbalance in the parties' rights and obligations is required for the Article to come into operation. The imbalance may be of an economic or of a legal nature. In the first case, the economic consequences are significantly abusive to the other party. In the latter case, a term may be deemed imbalanced if it confers rights upon one party and not upon the other (mirror image rule).

Illustration 3: A contract between a bank and a customer allows the bank to set off any claim it wishes and the consumer none. This causes a significant imbalance between the rights of parties.

H. Effect on Rest of Contract

If a term is found to be unfair, the remainder of the contract may remain in force if that is possible and appropriate, but if the rest of the contract cannot survive the deletion of the unfair term, the contract as a whole will be avoided. Cf Art. 6 of the Directive and Article 4:116.

I. Government Contracts

In some countries government services have sought to be exempt from legislation on unfair contract terms on the ground that they are working in the public interest. However, it has often been pointed out that government services are sometimes among the worst offenders of requirements of contractual fairness. These Principles may apply to all government contracts.

J. Other Legislation

Legislation on unfair contract terms usually contains a number of other provisions. These Principles include several Articles on interpretation of general contract terms. Especially in consumer contracts, national legislation may lay down other rules as well. These may also affect the procedural rights of the parties concerned.

NOTES

Article 4:110 is in the same terms as Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts of 5 April 1993, OJ L95/29, save that it is not limited to terms used against consumers. This reflects the law in many Member States. First, before passing any specific legislation many systems had adopted or developed judicial controls over unfair terms. These are not usually limited to consumer contracts and, for the most part, they continue to apply. Second, many member States have legislation on unfair terms which applies to unfair terms, particularly those in general conditions of contract, even when neither party is a consumer.

1. Judicial controls developed by the courts.

Examples of judicial controls over unfair terms, not limited to consumer contracts, are in GERMAN law, where clauses might be declared invalid under the public policy test of BGB § 138 or as contrary to good faith as required by § 242; in GREECE, under the general principle of CC arts. 281, 178 and 179 on good faith and good mores, art.371 in inequitable determination of indefinite performance or arts. 372-373 on determination of performance left to the discretion of one party; BELGIAN law, where clauses may be declared invalid under the public policy test of CC arts. 6 and 1131 or if they constitute an abuse of right, as contrary to good faith; and DUTCH law, which invalidated unfair clauses if they were contrary to the requirement of good

faith or, as the BW now puts it, reasonableness and equity (art. 6: 248(2)). In other countries the judicial controls were more limited. For example, in the U.K. there were attempts by the courts to prevent the use of unfair exemption and limitation of liability clauses by holding that they could not apply when there had been a fundamental breach of contract, but the House of Lords held that there was no rule to this effect, though the courts will interpret such clauses narrowly: *Suisse Atlantique Société d'Armement Maritime SA v. Rotterdamsche Kolen Centrale NV* [1967] 1 A.C. 361; *Photo Production Ltd v. Securicor Transport Ltd* [1980] A.C. 827.

2. Legislation applying to general conditions.

Before the implementation of the Directive on Unfair Terms in Consumer Contracts, some countries still gave individual plaintiffs relief against unfair clauses primarily through controls which were not aimed specifically at general conditions, e.g. in the NORDIC countries, Contracts Act § 36 remains a primary basis of relief. More usually specific legislation had been adopted, particularly on terms contained in general conditions. This is sometimes limited to clauses used against consumers or “non-professionals”, e.g. the system of administrative control set up in FRANCE by the *loi Scrivener* of 10 June 1978 and the subsequent cases in which courts have held that abusive clauses in consumer contracts are of no effect (e.g. Civ. 14.5.1991, D. 1991.449 note J.Ghestin; see *Malaurie & Aynès*, Obligations, § 612); LUXEMBOURG legislation of 25 August 1983 (Memorial 1983A, p.1494); BELGIAN consumer law, especially Trade Practices and Consumer Protection Act of 14 July 1991, arts. 31 ff.; but frequently the legislation applies to both consumer and non-consumer contracts. An example is the GERMAN Act on Standard Terms (AGBG) of 1976. Although the AGBG’s “grey” and “black” lists of clauses, respectively presumed to be unfair until the contrary is shown (§ 10) and always deemed to be unfair (§ 11), apply directly only to consumer contracts and not to commercial contracts between persons acting in the course of their trade, the general provision (§ 9) applies to all contracts except certain categories specifically exempted from the Act by § 23(1). The black and grey lists may be applied by analogy under § 9, see *Münchener Kommentar (-Kötz)* 1, AGBG § 9 Nos. 18, 19; BGH 8 March 1984, BGHZ 90, 273, 278; BGH 3 March 1988, BGHZ 103, 316, 328; BGH 25 October 1995, NJW 1996, 389. DUTCH BW arts. 6:231-247 apply to general conditions of all types but have black lists (art 6:236) and grey lists (art.6:237) in favour of consumers and small enterprises. PORTUGUESE decret-loi no. 446/85 of 25 October 1985 has two black lists and two grey; in each case one list applies to all contracts (arts 18 and 19) and a second, more demanding, list (arts. 21 and 22) applies to consumer contracts. AUSTRIAN law has specific rules for consumer contracts in the Consumer Protection Act of 8 March 1979, BGBI 1979/140, including a blacklist; and a more general provision in ABGB § 879.

Some countries had adopted legislation which can apply to individually negotiated terms but only if they are of a particular type: e.g. Italian CC art. 1341(2) and Luxembourg CC art.1135-1 (which provide that certain clauses are valid only if specifically accepted by separate signature). U.K. Unfair Contract Terms Act 1977 and Irish Sale of Goods and Supply of Services Act 1980 apply to various types of

exclusion and limitation clause irrespective of whether the clause was individually negotiated. Compare Article 8:109 of the Principles.

All Member States are now obliged to implement the Directive. In the Netherlands and Portugal it is considered that the Directive does not require any changes to the BW or the law of 25 October 1985 respectively. A general survey of the implementation in the various Member States may be found in the *European Review of Private Law* [1997] Vol. 5, 121 ff.

3. Significant imbalance, contrary to good faith and fair dealing

The test used by the systems to determine whether or not a clause was valid varied in formulation: e.g. the BELGIAN Act of 14 July 1991 to ‘manifest disproportion’; the GERMAN AGBG § 9 to good faith and unreasonable disadvantage; the NORDIC Contract Acts to ‘unfair’; the U.K. Unfair Contract terms Act 1977 to “fair and reasonable”. It is not thought that the various formulations produce significantly different results to that adopted by the Directive and thus of and Article 4:110, but some recent legislation adopts the terms of the Directive explicitly, e.g. French L.132.1 now refers to ‘*déséquilibre significative*’, and the UK Unfair Terms in Consumer Contracts Regulations 1994 to ‘significant imbalance’, contrary to the requirements of good faith. For a comparative account of the approach to unfairness in the Directive see *Sepe*.

4. No review of the price

The legislation of several Member States specifically excludes courts from reviewing the price or other main terms: e.g. DUTCH BW 6:231(a) in fine. However, under NORDIC law even the price may be reviewed under Contracts Act § 36.

5. Applicability to contracts with Government.

In the majority of systems which apply controls to non-consumer contracts the legislation does not differentiate between contracts with the Government and other contracts. Cf. *Calais-Auloy & Steinmetz*, no.12.

On unfair terms generally, see *Kötz*, European Contract, ch.8. On the laws before the Directive see *Hondius*, Unfair Terms.

Article 4:111: 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 by giving information, or knows of or ought to have known of a mistake,*
 - (b) gives incorrect information,*
 - (c) commits fraud,*
 - (d) makes a threat, or*
 - (e) takes excessive benefit or unfair advantage,*
- remedies under this Chapter will be available under the same conditions as if the behaviour or knowledge had been that of the party itself.*
- (2) *Where any other third person:*
- (a) gives incorrect information,*
 - (b) commits fraud,*
 - (c) makes a threat, or*
 - (d) takes excessive benefit or unfair advantage,*
- remedies under this Chapter will be available if the party knew or ought to have known of the relevant facts, or at the time of avoidance it has not acted in reliance on the contract.*

COMMENT

A. Responsibility for Agents, Employees and Others

Under the Principles a party is generally treated as responsible for not just the actions of its employees but also of those whom it involves in the making of the contract or to whom it delegates performance: see also Article 1:305. 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 him. 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 he was acting for the party.

Illustration1: 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 under Article 4.103 or 4:107 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.

A party cannot be fixed with the consequences of improper or careless behaviour of a third person for whom it is not responsible and who does not fall into the other categories mentioned in Comment A. But it should not be allowed to enforce a contract which it knows or should know was concluded only through such behaviour by a third person, if, had it behaved in the same way itself, the other party to the contract could have a remedy under the 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 under Article 4:117 if it knows of the ground for avoidance, or if it knows that the other party has been given incorrect information by a third person 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 fundamental mistake if the mistake was known to the other party, see Article 4:103.

D. No Reliance on Contract by Other Party

It also seems fair to allow a party which has entered 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.

NOTES

1. Actions by a third person for whom a party is responsible.

All Member States adopt the principle that a contract may be avoided against a party whose employee or agent has behaved in such a way that, if the agent or employee had himself been the party to the contract, it could have been avoided on one of the grounds described in this chapter. E.g. AUSTRIAN ABGB § 1313(a); ENGLISH law, see *Chitty* § 6-014.

2. *Actions by a third person for whom the party is not responsible.*

As noted earlier, some systems allow avoidance of a contract entered as the result of a threat by a third person for whom the other party was not responsible, even if the other party did not know and had no reason to know of the threat (notes to Article 4:108 above). The majority of systems, however, hold that the contract may be avoided for duress or any other factor mentioned in this chapter only if the other party participated in the misbehaviour or knew or should have known of what was happening: e.g. AUSTRIAN AGBG § 875 (participation or actual knowledge); DUTCH BW art. 3:44(5); GREEK CC Art. 153 (duress; no rule stated for other cases). Some of the systems which do not require knowledge in the case of duress do require it in case of fraud, e.g. FRENCH and LUXEMBOURG law (CCs Art. 1111 cover only *violence* by a third person); GERMAN BGB § 123(2); ITALIAN CC art.1338 (party who knew or ought to have known that incorrect information given treated as himself guilty of pre-contractual fault); arts. 1447, 1448 (in cases of danger or need, relief only when known to party himself or to third person who was acting as agent.); NORDIC Contracts Acts §§ 29-31 (knew or ought to have known); PORTUGUESE CC art. 254(2) (fraud; not required in cases of exploitation of the weak position of a contracting party under art. 282, *Mendes* 129; *Eiró* 69). In SPAIN, the courts have interpreted CC art. 1269 as limited to cases of fraud by one of the contracting parties but this approach is criticised, e.g. by *Lasarte Álvarez*, § 3.6(c).

In ENGLISH law it has been held that if a lender is given a guarantee or security by a party to whom the arrangement is of no advantage and who the lender should know has a relationship with the debtor (e.g. they are husband and wife) such as to make duress, misrepresentation or undue influence a likely reason for the guarantee being given, the lender must advise the surety to seek independent advice. If the lender fails to do this, it will be fixed with constructive notice of any impropriety which has occurred: *Barclays Bank v. O'Brien* [1994] 1 A.C. 180, H.L. In SCOTLAND a similar result has been reached but via the different route of recognising a duty of good faith by the creditor towards the surety: *Smith v. Bank of Scotland* 1997 S.L.T. 1061 (H.L.).

3. *Fraud etc by a third person where the party against whom avoidance is sought did not know of the fraud but has not relied on the contract.*

The question whether the party has relied on the contract may exceptionally be taken into account in NORDIC law, Contracts Acts § 39. It is not relevant in BELGIAN, DUTCH, ENGLISH, FRENCH GERMAN, GREEK or LUXEMBOURG law.

Article 4:112: Notice of Avoidance

Avoidance must be by notice to the other party.

COMMENT

Avoidance may be effected by the party entitled to avoid the contract or communication; it is not necessary to seek a court order to avoid the contract. Under Article 1:303 the receipt principle applies and the avoidance will not be effective unless the notice reaches the other party.

Conduct unequivocally indicating that a party no longer considers itself bound by the contract will amount to avoidance if it is 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 takes a job with another company. The contract is avoided as soon as B reads of this in the newspaper even if A has not communicated his avoidance directly to B.

Provided the time limit for avoidance has not passed (see Article 4:113), a party may give notice of avoidance by raising the ground of avoidance as a defence when an action is brought against it by the other party.

NOTE

In some systems the effect of some of the grounds for invalidity mentioned in this chapter is that the contract is altogether void (e.g. for *erreur obstacle* in FRENCH law and mistake at common law in ENGLISH law). In such case the party need not take any step to avoid the contract, though action may be necessary to recover property, money or payment for services transferred.

Where the contract is merely voidable, in many of the legal systems of Member States, a contract may be avoided on the traditional grounds of invalidity by simple notice to the other party: e.g. GERMAN BGB § 143; DUTCH BW art. 3:49; NORDIC law (*Gomard*, Kontrakret 142); ENGLISH and IRISH law (notice dispensed with if third party has deliberately gone into hiding and party seeking to avoid has taken all reasonable steps such as notifying police: *Car & Universal Finance Co Ltd v. Caldwell* [1965] 1 Q.B. 625, CA.); SCOTS law (notice to police insufficient, *McLoed v. Kerr* 1965 SC 253). However a court action is required in GREECE, CC art. 154; in FRANCE, BELGIUM and LUXEMBOURG (CCs art. 1117), unless the annulment is accepted by the other party; and similarly in ITALIAN law (CC art.1441) and PORTUGUESE law, *Lima/Varela*, I 264; *Ascensão* 440; *Fernandes* 393. In AUSTRIAN doctrine and court practice the opinion prevails

that avoidance on the ground of error requires a court decision, and that it is not sufficient to direct an informal notice to the other party. However this is doubtful as the ABGB does not require court proceedings.

Several systems have a different regime for unfair terms, under which the term is simply of no effect and so notice of avoidance is not needed. E.g. FRENCH CCons art. L.132.1 (above, note to art. 4:110), (*reputée non écrite*); similarly BELGIAN Act of 14 July 1991; LUXEMBOURG; GERMAN AGBG. Under the Directive, Member States are to provide that unfair terms will not be binding on consumers, art. 6(1).

Article 4:113: Time Limits

- (1) *Notice of avoidance must be given within a reasonable time, with due regard to the circumstances, after the avoiding party knew or ought to have known of the relevant facts or became capable of acting freely.*
- (2) *However, a party may avoid an individual term under Article 4:110 if it gives notice of avoidance within a reasonable time after the other party has invoked the term.*

COMMENT

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 it learns the relevant facts, or, in cases of duress or undue persuasion, it is free of the threat or influence of the other party.

B. Knowledge of Facts

The party should act within a reasonable time of learning the relevant facts; it is not necessary that it know that they give it a right to avoid the contract. If it is in doubt it should take legal advice. A reasonable time will include time to take advice and consider its position.

C. Avoidance of Term

Under Article 4:110 if a particular term is unfair the disadvantaged party may avoid just that term.

Often it will not be clear to the party that he will be disadvantaged; it may depend on whether and how the other party invokes the term. Thus it seems fair to allow the potentially disadvantaged party to “wait and see”.

Illustration: A bank’s general conditions for the lease of equipment to a farmer allows it, as the lessor, in the event of any default by the lessee, to seize not only the equipment concerned but also any other equipment separately leased from the lessor, even if there has been no default in paying for the other equipment. Such a “cross-default” clause results in an excessive advantage to the bank. The farmer need not protest about it, however, until a default occurs and the bank tries to seize other equipment.

A clause requiring earlier notice would itself fall within Article 4:110.

If a party who could have invoked Article 4:110 against a term enters into an agreement with the other party to settle the dispute, the first party does in effect lose the right to challenge the term. That is because he is bound by the settlement, not because of the right to challenge the original term is lost.

NOTES

1. Avoidance for defect in consent

There is wide variation between the systems on the time within which avoidance must be sought. In ENGLISH law it has been held that the right to avoid a contract for misrepresentation may be lost within a matter of weeks, even though the misrepresentation has not been discovered (see *Leaf v. International Galleries* [1950] 2 K.B. 86, C.A. and *Bernstein v. Pamson Motors (Golders Green) Ltd* [1987] 2 All E.R. 220, Q.B.D.), or within months of the cessation of duress (*North Ocean Shipping Co Ltd v. Hyundai Construction Co Ltd* [[1979] Q.B. 705, Q.B.D.). In cases of fraud time will not run until the fraud has been discovered but then prompt action will be required: see *Chitty* § 6-079. At the other, BELGIAN CC art. 1304 (as am. in 1976) gives 10 years from the discovery of the fraud or error or the cessation of the threat, and even after that time the error, fraud or threat may be raised as a defence.

The other systems take intermediate positions. FRENCH CC art. 1304 allows 5 years from cessation of threat or from discovery of fraud or error; ITALY CC art. 1442 similarly, and in other cases five years from date of contract; LUXEMBOURG, as French law but one year in cases of unfair advantage, CC art.1118; SPAIN, four years from end of threat or, in cases of fraud and error, from date of contract, CC art 1301; GERMANY: mistake, without delay (§ 121; two weeks was regarded as the upper limit by OLG Hamm 9 January 1990, NJW-RR 1990, 523); fraud or threat, one year from discovery or cessation, BGB § 124; AUSTRIA, threat or mistake, 3 years ABGB § 1487; fraud or usury, 30 years. GREECE, two years after error, fraud or threat has ceased and in any event within 20 years from the conclusion of the contract (CC art. 157); HOLLAND: 3 years from date of discovery of fraud or error or cessation of threat, BW art. 3:52; otherwise three years from when right of avoidance arises. NORDIC law: Contract Acts §§ 28(2) (physical violence) and 32(2) (message incorrectly communicated by intermediary), notice of avoidance must be given without unreasonable delay; otherwise, general limitation period. However, in Denmark the right to avoid may be lost if not claimed for a long period, see *Lynge Andersen* 169; in Finland, if the party wishing to avoid knew that the other has acted in reliance on the contract yet did not react within a reasonable time, he will be held to have lost his right: *Ämmälä*, Helsinki 1993). SCOTS law has no set time limits except a general prescription period of twenty years (Prescription and Limitation (Scotland) Act 1973, s. 8.), but a right to avoid maybe lost be failure to exercise it promptly. In PORTUGAL, the contract must be avoided within a year if it has been executed but if it has not been executed there is no time limit (CC art. 287 (1) and (2)).

2. Avoidance of an individual unfair term

Several systems simply apply the same general rule to avoidance of an individual unfair term e.g. GERMANY (but under AGBG simply void); HOLLAND, BW 6:235(4), which starts time running from date clause invoked by other party; ITALY, CC art. 1442(4); *semble* in NORDIC law. In others the clause is simply of no effect, e.g. LUXEMBOURG; PORTUGAL Law of 25 October 1985; U.K. Unfair Contract Terms Act 1977. Under the Directive, Member States are to provide that unfair terms will not be binding on consumers, art. 6(1), which seems to imply that the clause may be challenged at any time.

Article 4:114: Confirmation

If the party which is entitled to avoid a contract confirms it, expressly or impliedly, after it knows of the ground for avoidance, or becomes capable of acting freely, avoidance of the contract is excluded.

COMMENT

A party cannot be allowed to avoid a contract after it has indicated that it wishes 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 it becomes capable of acting freely. However, if even without knowledge of the ground for avoidance, a party has given a clear indication that it intends to continue with the contract and the other party has acted on that information, the first party may be prevented from going back on its word. It will have given the appearance of having intending to confirm the contract (cf. Article 2:102, Intention) and to go back on this when the other party has acted on it would be contrary to Article 1:201, Good Faith and Fair Dealing.

Where a party has the right under Article 4:110 to avoid a particular term, the rule in Article 4:114 will not apply just because it knows it can avoid the term; it may wait to see if the other party invokes the term.

NOTE

This provision is broadly the same as FRENCH, BELGIAN and LUXEMBOURG law (CC art.1338); GERMAN law, BGB § 144 (confirmation may be implicit, e.g by continuing to use goods, BGH 28 April 1971, NJW 1971, 1795, 1800, provided that the party knew he had a right of avoidance or expected to have such a right, BGH 8 March 1961, WM 1961, 785, 787); ITALIAN CC art. 1444 (but confirmation is not recognised in cases of lesion or of iniquitous terms accepted in situations of danger); PORTUGUESE CC art. 288; SPANISH CC arts 1309ff.; DUTCH BW arts. 3:55 and 3:35 (act which reasonably appears to be a confirmation). In ENGLISH and IRISH law the right to avoid may be lost through election, which in principle requires knowledge of the right to avoid, though an act which is done without knowledge of the right to avoid but which reasonably leads the other party to believe that the contract will not be avoided may give rise to an estoppel, see *The Kachenjunga* [1990] 1 Lloyd's Rep. 391, H.L., per Lord Goff at 399). It appears that NORDIC law reaches

this result also: *Ämmälä*, pp. 222-224; *Lynge Andersen* 169; *Gomard*, *Kontraktsret* 141. There is little clear authority on these questions in SCOTS law.

Article 4:115: Effect of Avoidance

On avoidance either party may claim restitution of whatever it has supplied under the contract, provided it makes concurrent restitution of whatever it has received. If restitution cannot be made in kind for any reason, a reasonable sum must be paid for what has been received.

COMMENT

A. Restitution

Avoidance involves setting aside the contract, or the part of it avoided, as if it had not been made. The mutual restoration of benefits, or where the benefits themselves cannot be returned, their value, is a natural consequence; it would not be right that avoidance should leave either party with a benefit at the other's expense. If it is possible, restitution may be made in kind; if this is not possible, for instance because an innocent third party has acquired rights over the property, a reasonable sum should be paid instead. The right to restitution depends upon the party making concurrent restitution of benefits it itself received, compare Article 9:201, Right to Withhold Performance.

B. Effect of Avoidance on Application of the Principles.

A dispute about whether the contract was validly formed will still be governed by the Principles, see Article 1:104, even if the conclusion is that the contract should be avoided.

NOTES

1. Restitution after avoidance

The legal systems of the Member States agree that after avoidance of a contract the parties may recover the value of performances they had rendered before avoidance by way of restitution.

There are no particular differences between the systems in two situations. First, when money has been paid over, under all systems it must be repaid. Second, when services have been performed, the recipient must make restitution by paying their reasonable value. The Principles do not deal with the question of how the value is to be calculated.

However there are differences in the way that the systems treat restitution of property which was purportedly transferred under the contract which has been avoided. This involves questions of the effect of avoidance and of the extent to which avoidance is permitted when restitution in kind is not possible or is not permitted.

2. Does avoidance re-vest property?

Many legal systems of the Member States apply generally the rule that property which was transferred automatically re-vests in the transferor. So, in FRENCH and LUXEMBOURG law the theory of nullity holds that the parties are to be treated as if the contract had never existed, see *Malaurie & Aynès*, Obligations 579-592. ITALIAN law adopts a similar principle. In AUSTRIAN law, invalidation of the contract itself invalidates the transfer of title and the transferor remains legal owner (OGH 30 January 1980, JBI 1981, 425). Also in ENGLISH and IRISH law, if the contract is void for mistake (see note to Article 4:103, above) no property is transferred (e.g. *Ingram v. Little* [1961] 1 Q.B. 31, C.A.); if the contract is voidable and is validly avoided, the property re-vests in the transferor (e.g. *Car & Universal Finance Co Ltd v. Caldwell* [1965] 1 Q.B. 625, C.A.) In other systems, annulment of the contract is not necessarily seen as having retroactive effect on property rights which have been transferred. Thus in GERMAN law, according to BGB § 142(1), a contract which has been avoided is treated as being void from the time of conclusion of the contract; but in cases of avoidance for mistake, for example, this does not itself affect any transfer of property since German law separates the passing of property from the underlying contract. The transferor must rely on a claim in unjust enrichment under BGB § 812(1) and, if the recipient is bankrupt, the claimant will receive only a dividend in the bankruptcy. However, a different rule is applied in cases of fraud and threat. Here, since these grounds for avoidance are strongly tainted, avoidance of the contract extends to the transfer of property also, so the avoiding party may vindicate the property itself even if the other party is bankrupt (BGB § 985). SCOTS law also treats contract and transfer of property as distinct juridical acts.

The Principles do not deal with questions of property and take no position on whether avoidance produces an automatic re-transfer of property, with a concomitant right to restitution of any property transferred as such, or merely to a personal right to restitution. Nor do they deal with the position of third parties who may claim an interest in the property.

3. Impossibility of restoring the property transferred

Under ENGLISH, IRISH and SCOTS law, if the property cannot be restored in substantially the same condition as when it was transferred, for example through being used up, the right of avoidance is lost (though the rule is applied flexibly, see *Chitty* §§ 6-070 - 072). The Principles do not follow this approach. Continental systems generally allow avoidance in such a case; they may require the party who received the property, instead of returning it, to make restitution of its value. Under Article 4:115, inability to restore property transferred is not a bar to avoidance; the party who received the property may have to make restitution of the value of the benefits received.

There are widely differing rules as to who bears the risk of accidental destruction of the property between the date of the transfer and that of avoidance, and

thus whether restitution must be made in such a case: see Treitel, *Remedies* § 285. The Principles do not deal with this question.

Article 4:116: Partial Avoidance

If a ground of avoidance 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.

COMMENT

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 ball room gown 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.

If a party is entitled to avoid a term because it is unfair under Article 4:110 this may be done without reference to Article 4:116.

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 it to avoid just the term involved and this would not result in the contract being unbalanced in its favour.

Illustration 2: B, a builder, 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 it can avoid the price stated 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 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 shall be on the party which 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 it so wishes.

NOTES

In some systems, when there is a ground of validity affecting only part of the contract, and the clause is not essential to the rest of the contract, the contract may be upheld without the offending clause. This is the case with unfair clauses, both under the Directive on Unfair Terms in Consumer Contracts and many national laws; but it is in some systems true for other grounds of invalidity, e.g. in FRENCH, BELGIAN and LUXEMBOURG law (see *Malaurie & Aynès*, Obligations §§ 580-584); in GERMAN law, if the clause is severable within BGB § 139; similarly in DUTCH law, BW art. 3:41. Other systems allow avoidance of the whole contract if the avoiding party can prove that he would not have entered the contract at all without the offending part: e.g. GREEK CC art.181; ITALIAN CC 1419 (cases of nullity); PORTUGUESE CC art. 292. This is the result reached by BELGIAN case law.

In NORDIC law the remedy is in principle avoidance of the whole contract but in practice there have been cases in Finland in which partial avoidance has been used (KKO 1961 II 100 and 1962 II 80) and in all Nordic countries the aggrieved party may ask for adjustment of the contract under Contracts Act § 36. In ENGLISH, IRISH and SCOTTISH law the remedy is usually thought of as avoidance of the whole contract, and in a recent case of misrepresentation as to the content of a contract, the court refused to enforce the contract in the form that the misrepresentee had been led to expect (*TSB Bank plc v. Camfield* [1995] 1 W.L.R. 430, C.A. But where a party misrepresented the effect of an exclusion clause in a contract the court simply enforced the rest of the contract without the clause, *Curtis v. Chemical Cleaning Co Ltd* [1951] 1 K.B. 805, C.A.

Article 4:117: Damages

- (1) *A party which avoids a contract under this Chapter may recover from the other party damages so as to put the avoiding party as nearly as possible into the same position as if it had not concluded the contract, provided that the other party knew or ought to have known of the mistake, fraud, threat or taking of excessive benefit or unfair advantage.*
- (2) *If a party has the right to avoid a contract under this Chapter, but does not exercise its right or has lost its right under the provisions of Articles 4:113 or 4:114, it may recover, subject to paragraph (1), damages limited to the loss caused to it by the mistake, fraud, threat or taking of excessive benefit or unfair advantage. The same measure of damages shall apply when the party was misled by incorrect information in the sense of Article 4:106.*
- (3) *In other respects, the damages shall be in accordance with the relevant provisions of Chapter 9, Section 5, with appropriate adaptations.*

COMMENT

A. Liability in Damages

It is not sufficient that the party which has entered a contract because of mistake which the other party did not share, fraud, threats or excessive or unfair advantage should only have a right to avoid the contract or part of it. First, it may not wish to exercise its right of avoidance. In such a case should it be without any remedy? At the very least it should be entitled to recover any gain that the other party made at its expense as a result of the conduct giving rise to the right of avoidance.

However, the recovery of this “restitutionary” interest may not suffice. It may have suffered some further loss which it would not have done had the wrong not been done to it. It should be entitled to recover the amount of its injury. Article 4:117 permits this.

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, he 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.

Note that in many legal systems liability in these cases would be regarded as delictual. Nonetheless, if the contract is subject to the Principles, so should be any claim under this Article. See Comment G to Article 4:106, above.

It may be that on some facts the tenant in Illustration 1 would have a claim for non-performance, e.g. under Article 6:101, Statements giving rise to Contractual Obligations. In this case the damages would include any higher cost involved in finding another house with drains which are in good order, see next Comment.

B. Measure of Damages

Damages for non-performance aim to put the aggrieved party into the position it would have been in had the contract been performed, see Article 9:502. In cases within Chapter 4 there has not been a non-performance, or at least not necessarily so: even in cases of fraud or incorrect information, the person making the statement is not necessarily giving a contractual undertaking that it is true, see Comments to Article 6:101, Statements giving rise to Contractual Obligation. If there was no promise that what was stated was true, the untrue statement should not have caused any “loss of expectation” and the damages should not include an element for this. The aim should be to put the party back into the position it would have been in had it not entered the contract (see also Comment to Article 4:106(2)).

Illustration 3: L lets a flat to T, telling T that the occupier of the flat has the right to use a garden in the square opposite the apartment building. L should have known that this is not true. T agrees to pay £400 per month; the normal rent for such a flat would be £350 a month. Some similar flats in the building do have the use of the garden; the “going rent” for these is £500 a month. T may recover damages of £50 a month, not of £150 a month.

Sometimes a statement which is made fraudulently, or which is incorrect, does also amount to a contractual promise within Article 6:101. In this case the aggrieved party may choose between remedies under this chapter or remedies for non-performance, see Article 4:119.

If the contract has been avoided and the aggrieved party suffered no consequential loss, there may be no further loss which is compensable under this Article.

Illustration 4: 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 compensable under this Article, even if it costs him more to lease a car from another company.

Damages under Article 4:117 may include compensation for opportunities which the party passed over in reliance on the contract.

Illustration 5: E accepts an offer of employment from F after F fraudulently tells him that the job carries an index-linked pension. E finds that the job does not have such a pension scheme and he resigns. To take the job he had passed up another job offer at a much better salary than he can now get elsewhere. E may recover as damages the difference between what he would have earned in the other job and the salary he can now get.

C. Measure of Damages Where the Contract is Not Avoided.

A party which has the right to avoid the contract but does not do so, for instance because it fails to act quickly enough to avoid the contract, should, as we have said, be able to recover damages. However, it should not necessarily be put into the same position as if it had not entered the contract. To allow this might permit it 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. The same applies particularly to case of incorrect information under Article 4:106.

Illustration 6: 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 not serious enough to constitute a mistake within Article 4:103 but it will cost £10,000 to divert the path. A has a claim under Article 4:106. 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 failed to look after its own interests and thus contributed to its loss. In such a case the damages may be reduced cf. Article 9:504, Loss Attributable to Aggrieved Party, and Article 9:505, Reduction of Loss.

F. Damages after Adaptation of Contract

The adaptation of the contract by the other party or by the court under Article 4:105 does not preclude the mistaken party claiming damages under this Article if it has suffered loss which is not compensated by the adaptation of the contract.

G. Exclusion or Restriction of Liability in Damages

On exclusion or restriction of liability in damages, see Article 4:118.

NOTES

1. Availability of damages

It is widely recognised that damages are available where the ground for avoidance of the contract was the result of the fault of one of the parties. This may be based on general principles of delictual responsibility (as in FRENCH and LUXEMBOURG law, CCs art.1382; in BELGIAN law, *culpa in contrahendo* is seen as an application of general tort principles); or on “contractual” *culpa in contrahendo* (as in ITALIAN law, see *Sacco(-De Nova)*, Il contratto, II p.575 ff.); or on either ground. Thus in GERMAN law, in a case of excessive advantage taking, the victim may recover damages if the requirements of BGB § 826 or those of *culpa in contrahendo* are fulfilled, BGH 12 November 1986, BGHZ 99, 101, 106. PORTUGUESE law is similar: STJ, 13 January 1993; O Direito 125, I-II, pp.145 ff.; *Cordeiro* 157ff.; *Prata* n.17, 45, 53, 58; *Prata*, n.16, 167ff.. NORDIC law probably also allows claims on either basis, though there is little authority; in Danish law it is accepted that the aggrieved party may recover his reliance losses if the other party has acted negligently or in bad faith, *Gomard*, Kontraktsret 140. See also *Ramberg*, Pre-contractual liability and *Kleineman*. In some systems general principles may be supplemented by special provisions on particular topics, as in AUSTRIAN law, where ABGB § 874 covers fraud and coercion, but error is dealt with by *culpa in contrahendo*; GREEK law, where a provision on error (CC art. 145) supplements the general delictual provisions (CC arts. 149, 152)

ENGLISH, IRISH and SCOTS law do not have rules applicable generally to cases covered by this Chapter of the Principles. Damages may be recovered for fraud and for negligent misrepresentation (e.g. English Misrepresentation Act 1967, s.2(1); Irish Sale of Goods and Supply of Services Act 1980), s.45; Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, s.10.) Duress may in certain circumstances amount to a tort: see *Carty and Evans*. Even in the rare cases in which English law recognises a duty of disclosure, non-disclosure is normally only a ground for avoidance of the contract and not for damages, unless the non-disclosing party has assumed responsibility towards the other within the doctrine of *Hedley Byrne & Co Ltd v. Heller & Partners Ltd* [1964] A.C. 465, H.L.: see *Banque Financière de la Cité SA v. Westgate Insurance Co Ltd* [1989] 2 All E.R. 952, C.A., at p.1007. It does not appear that damages can be given in other cases of mistake not involving misrepresentation, nor in cases of undue influence. Equally SPANISH law has rules on specific situations, e.g. CC art. 1270(2) on fraud.

2. Measure of damages

In those systems in which the measure of damages is discussed, it is generally accepted that in cases of *culpa in contrahendo* and delictual claims only the plaintiff's negative interest, or reliance loss, will be compensated: GERMAN law; NORDIC law (see on Finnish law *Taxell*, Avtal och rättsskydd 391); ENGLISH law (fraud: *East v. Maurer* [1991] 1 W.L.R. 461, C.A.; negligent misrepresentation, *Royscot Trust Ltd v. Rogerson* [1991] 2 Q.B. 297, C.A.). It has been argued that in DUTCH law a mistaken party may be able to claim his expectation interest: *Asser-Hartkamp*,

Verbintenissenrecht II nr. 487. In PORTUGUESE law, some writers accept that negative interest damages are sufficient, e.g. *Costa*, Responsabilidade n. 3712, 206ff.; others argue that sometimes the positive interest should be protected, *Lima/Varela I* 216; *Prata*, n. 17, 98.

Illustration 6 is modelled on the English case of *Sindall (William) plc v. Cambridgeshire County Council* [1994] 1 W.L.R. 1015, C.A., and the Article produces a similar result to that which the court indicated it would have reached if there had been a misrepresentation. On the facts, no misrepresentation had been made.

Article 4:118: Exclusion or Restriction of Remedies

- (1) *Remedies for fraud, threats and excessive benefit or unfair advantage-taking, and the right to avoid an unfair term which has not been individually negotiated, cannot be excluded or restricted.*
- (2) *Remedies for mistake and incorrect information may be excluded or restricted unless the exclusion or restriction is contrary to good faith and fair dealing.*

COMMENT

Fraud, threats and excessive or unfair advantage taking are of such seriousness that a party should not be able to exclude or restrict its liability; they are all forms of bad faith, cf. Article 1:201. There is a close parallel here to clauses which purport to exclude or limit liability for intentional non-performance and which are invalid under Article 8:109.

Mistake and the giving of incorrect information do not involve bad faith and it is permissible to exclude or restrict remedies for them provided that the clause 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. Compare the Comment to Article 4:110.

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.

See Comments to Articles 4:106, 4:107, 4:108 and 4:109.

This Article does not prevent a party agreeing to a settlement of a claim which in effect involves surrendering rights under this Chapter. See Comment to Article 4:114 Confirmation, above.

NOTE

Those legal systems in which this question has been discussed have generally held that remedies for grounds of invalidity involving immoral behaviour cannot be excluded, but that remedies for others may be. Thus in FRENCH law the parties may exclude remedies for mistake. In GERMAN law, remedies for mistake may be excluded by an individually negotiated term, though generally not in general conditions, BGH 28 April 1983, NJW 1983, 1671; exclusion is not possible if an agreement is *contra bonos mores* within BGB § 138. SPANISH CC art. 1102 prevents exclusion of liability for fraud. PORTUGUESE law would appear to prevent exclusion of liability for what is contrary to good morals, CC art. 280(2). In AUSTRIAN law, remedies for mistake caused by simple negligence may be excluded, OGH 20 March 1968, SZ 41/33; 7

March 1978, RZ 1979/14, but remedies for fraud cannot be and the same is probably true for gross negligence, OGH 19 December 1991, SZ 64/190. In NORDIC law the rules on avoidance in Contracts Act §§ 28-36 are mandatory; but liability for misrepresentation by simple negligence may sometimes be excluded (see e.g. Swedish Supreme Court NJA 1987 s.692, 703; the clause may have to be reasonable, *Gomard*, Kontraktsret 187). In ENGLISH law, remedies for fraud cannot be excluded (*Pearson v. Dublin Corp.* [1907] A.C. 351, H.L.); a clause excluding or restricting remedies for any other type of misrepresentation will only be valid if it is fair and reasonable, Misrepresentation Act 1967, s.3 (as amended by Unfair Contract Terms Act 1977, s.8). Unfair Terms in Consumer Contract Regulations 1994, SI 1994 no. 3159 may also apply. For IRELAND, see Sale of Goods and Supply of Services Act 1980 and EC Unfair Terms in Consumer Contract Regulations, SI 27 of 1995.

Article 4:119: Remedies for Non-performance

A party which is entitled to a remedy under this Chapter in circumstances which afford that party a remedy for non-performance may pursue either remedy.

COMMENT

In some situations the same facts may be analysed either as a case of mistake or incorrect information, or as one in which there is a non-performance. For example there may be a remedy for non-performance under Article 6:108 Quality of Performance, because the performance of one party is not of average quality; or one party may have given a contractual undertaking that a particular fact relating to the performance is true, see Article 6:101, Statements giving rise to Contractual Obligations.

In such cases there seems no good reason to prevent the aggrieved party from choosing which set of remedies to pursue. Normally the remedies for non-performance will give a fuller measure of recovery, but the aggrieved party may find it simpler to exercise its rights under this Chapter, 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 cannot, for example, both avoid the contract and claim damages for non-performance. Cf. Article 8:102 below.

NOTE

In GERMAN law, when the case falls within the special rules on defective goods, the buyer's only remedy is under those provisions. Other systems accept that there may be overlaps between the various sets of rules and allow the aggrieved party to choose which remedy to apply. Thus in FRENCH law a plaintiff will often seek annulment of the contract for error when he could have *recours en garantie*; the jurisprudence allows the victim to choose, Civ.3, 18 May 1988, B.III, No. 96. See *Ghestin*, Formation, nos.544-548. The boundary between the *garantie* and *erreur* is rather unclear, see *Malaurie & Aynès*, Contrats spéciaux no.284. Equally an aggrieved party may claim damages under CC art. 1382 in place of an action for nullity: Com. 14 March 1972, D. 1972.653, note Ghestin; Com.18 October 1994, D.1995.180 note C.Atiás. See generally *Tallon*, Hamel. BELGIAN law is in practice similar, as is LUXEMBOURG law, Cour 30 June 1993, Pasicrisie 29, page 253; Cour, 16 March 1900, Pasicrisie 5, 245. A choice of remedies is also permitted in AUSTRIA, GREECE, ITALY, THE NETHERLANDS and the NORDIC countries. In ENGLISH, IRISH and SCOTTISH law the principal overlap is between remedies for misrepresentation and for non-performance; here English Misrepresentation Act 1967,

s.1, confirms that the aggrieved party may choose. In PORTUGAL it appears that the party may choose between remedies for non-performance and for error, but that the same short limits laid down by CC arts. 916 and 917 and CCom. 471 will be applied whichever remedy is chosen, *Martinez*, 413.

See generally *Kötz*, European Contract 175-178.

