Termination and Adjustment of Contracts

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The success of the Principles of International Commercial Contracts speaks for itself. They have already been applied in a number of arbitrations, and the courts, too, have referred to provisions of the Principles. Above all, however, the academic community has embraced the UNIDROIT Principles enthusiastically, particularly in connection with ideas and projects for the unification of law. In addition, the provisions of the UNIDROIT Principles have influenced the drafting of new codes and the reform of old ones, especially in the formerly socialist countries of Central and Eastern Europe, and it is certainly no exaggeration to state that they have thus become akin to a model law.

What else could be added here? All the fundamental things have been said or published already, and the treatment of details can be tiresome or, especially if coupled with criticism, appear like petty superciliousness. Above all, justice can only be done to a work as magnificent as the UNIDROIT Principles if its basic structural decisions are evaluated in the context of the common development of the law, requiring a comparative analysis of particular issues. Any such attempt would, of course, exceed the limits of an article such as this, which consequently is restricted to a few observations about the topic of termination and adjustment of contracts.

A. Overview of the Relevant Provisions in the Principles

I. Termination of Contracts

In section 3 of chapter 7, the chapter on non-performance, the Principles provide a modern solution to one of the most difficult questions within the field of breach of contract or, to put it more neutrally, impediments to the performance of a contract: what is required in order to be able to terminate a contract which is not performed properly? It is obvious that termination always means an encroachment upon the basic principle of *pacta sunt servanda*, and the various national legal systems have, in the course of their legal history and depending on the time of codification, developed

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different solutions to the problem of how and under what conditions such termination, always regarded as an exception, should take place. An overview of the relevant parts of the UNIDROIT Principles will clarify where and how the drafters have deviated from certain concepts contained in domestic codifications. The best place to start is Article 7.3.1, which provides that a party can terminate the contract if the failure of the other party to perform a contractual obligation 'amounts to a fundamental non-performance'. In contrast to German law, but in accordance with Article 109(2) of the Swiss Law of Obligations (OR), the aggrieved party can, in addition, claim damages (Art. 7.4.1). This basic rule, which is fleshed out in greater detail in the following provisions, contains a number of innovations and simplifications in comparison to the corresponding rules in domestic legal systems, and deserves specific focus.

The rules on breach of contract are applicable to all types of violation of contractual obligations, regardless of whether there was no performance at all, whether performance was merely delayed or whether there was malperformance and, if so, what kind of malperformance, delivery of non-conforming goods, for example, or of goods encumbered with third-party rights, and also regardless of whether the obligation which was breached was an obligation fundamental to the contract or an ancillary obligation, such as an obligation not to compete within a certain region during a certain time. Similarly, the causes of the breach are not significant; whether the obligor is unable to perform the contract, whether the subject matter of the contract has been sold to another party, whether delay is caused by *force majeure* or by the obligor's own sloppiness – all these questions matter just as little as (at least in principle) the question of whether the obligor can be held responsible for the default. Indeed, the question of fault or no fault is in general of no relevance at all for the termination of a contract, although severe fault in causing non-performance may be an additional ground for termination.[1]

This rule, which mainly follows the lines of the Convention on the International Sale of Goods (CISG), means an enormous step forward compared to many domestic legal systems, where the remedy of termination for breach developed differently for particular types of cases, often leading to an incoherent body of rules. The oldest and best known remedy allowing termination of a contract is the *actio redhibitoria* of Roman law, the unwinding of a sales contract because of non-conformity of the goods.[2] Under the German system, the most prominent reason for the termination of a contractual obligation is impossibility, which can have different effects depending on the circumstances: if the impossibility is objective in nature (i.e. not merely due to the personal inability of the obligor to perform) and it has existed at the time when the contract was concluded, the contract is treated as void;

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[1] Compare ss. 325, 326 of the German BGB, which require a breach of contract (impossibility or delay) for which the obligor can be held responsible; and Art. 107 of the OR, *see* Honsell and Wiegand, Art. 97, marginal note 58.

[2] As to Swiss law, *see* Art. 205(I) of the OR.

otherwise, if the obligor is responsible for the impossibility, the other party is entitled to termination. In terms of legal dogma, termination because of non-conformity and termination because of impossibility (or part-impossibility) are located in different solar systems, but in practice they are bordering on each other and are sometimes difficult to distinguish. The type of breach which has the greatest practical importance, however, is late performance. Under Swiss law (OR, Art. 107) as well as German law (BGB, s. 326), termination for delay is possible provided that an additional period of time has been set; the drafters of the German and the Swiss Codes, however, only intended this model to apply to concurrent, 'synallagmatic', obligations.[3] The UNIDROIT Principles also allow this road to termination in Articles 7.3.1(2) and 7.1.5(3)1, but without limiting it in this manner.

If it is clear that there will be a fundamental non-performance, Article 7.3.3 provides that the obligee can terminate the contract even prior to the date set for performance. This governs the so-called anticipatory breach of contract, an area for which other European legal systems have developed solutions only by way of case law and outside the codified rules, and which still causes discussions as to the proper dogmatic characterization.

Another point of difference which should also be emphasized is the policy decision, incorporated in Article 7.3.2, to allow termination by 'formative' notice (*Gestaltungserklärung*). This deviates from French law, which has adopted the principle of *résolution* by court decision, but also from German law, where termination for non-conformity takes the form of a contract of termination whose conclusion can be required by the buyer.[4]

In contrast to Swiss and German law, but also to the CISG, the fate of the object of an obligation which has already been fulfilled is of no importance for the right of termination; in other words, buyers can terminate even if the object of the sale has been sold or has perished by their own fault.[5] Thus, the inability to return the object does not prevent termination; it merely becomes relevant in the context of the restitutionary obligations between the parties arising after termination. From the materials, it seems that the possibility of excluding termination, in the case of the goods having perished or having been severely damaged, was considered but dismissed by the drafters on the grounds that such a solution might be viable for

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[3] Under Art. 107 of the OR there is argument whether only the violation of concurrent obligations or the breach of every 'fundamental' obligation allows the setting of an additional period of time and termination after the lapse of this period; *see* Honsell and Wiegand, OR, Art. 107, marginal note 4. Interestingly enough, Wiegand in his discussion of the fundamentality of an obligation refers to Art. 25 of the CISG and, thereby, provokes a parallel to the fundamental rules of the UNIDROIT Principles.

[4] Under Swiss law there is argument whether *Wandelung*, i.e. termination in case of non-conformity, is brought about by a contract of the parties, by a 'formative' court decision or by a 'formative' notice of the buyer, cf. Honsell, OR, rt. 205, notes 1, 2.

[5] But *see* s. 351 of the BGB (and in regard to termination for non-conformity *see* s. 467 of the BGB); Art. 207(3) of the OR.

sales contracts, but not for other contracts, e.g. construction contracts, where the contractor must keep the right to terminate the contract in case of the other party's delay in payment even if the materials supplied by the other party were already used up in the construction. In fact, abandoning the idea that the right to termination can be lost in this way would seem a preferable solution for sales contracts, too, because it avoids the difficulties which are often caused by the preconditions for such an obstacle to termination and which often require intricate investigations into the causes of the loss or deterioration.

Finally, for purposes of restitution the UNIDROIT Principles do not distinguish between the types and circumstances of breach of contract; even the responsibility or fault of one party for the termination is of no importance for the content of restitutionary obligations. Instead, Article 7.3.6(1) provides a general rule of restitution, supplemented in paragraph (2) by a special provision on long-term contracts which have been partly performed, neither of which takes into consideration which party is responsible for the breach of contract.

In its basic structure, the concentration of all types of breaches of contracts allowing termination to two basic requirements, namely 'fundamental breach' or 'lapsing of an additional period of time for performance', is not too different from German or Swiss law. The distinctions are mainly a matter of emphasis. Swiss law in OR, Article 107 sets up the case of delay and termination after the lapsing of an additional period of time as the basic instance of termination. This is supplemented by a rule in Article 108 applicable to cases in which the breach of contract is so substantial that an additional period of time is unnecessary. Under the German BGB, the sequence is just the opposite. In section 325 the case of impossibility or part-impossibility caused by the obligor's fault appears as the central case of a fundamental breach of contract which allows termination, while the subsequent provision, section 326, which covers the case of an additional period of time set by the obligee, is seen merely as a kind of fall-back provision despite the fact that it is of much greater importance in practice.

Regardless of whether the additional-period-of-time case is meant as a fall-back provision or as the central norm, the decisive issue remains the determination of the exact prerequisites for termination without setting an additional period of time, in other words, the cases where an additional period of time is unnecessary (as the Swiss OR would put it) or where there is a 'fundamental breach' (to use the terminology of the UNIDROIT Principles). The Principles spell out a number of detailed descriptions and examples in Article 7.3.1(2) in order to make the concept of 'fundamental breach' more tangible. In lit. (b) the importance which certain clauses of the contract have for the parties and the need for strict compliance with these terms is decisive; this covers cases such as agreed delivery at a fixed date (*Fixgeschäft*). Lit. (d) covers cases of instalment contracts where non-performance of some instalments gives ground to believe that future performance will not be made properly either; this rule, too, can be found in German and Swiss case law and literature as a type of part-breach of contract which may allow the obligee to terminate the contract. Deviating from the basic principle that fault of the obligor in

breach is of no importance for the remedy of termination, lit. (c) provides that a breach may be fundamental because the obligor behaved intentionally or recklessly; the idea behind this solution might well be the realization that an intentional or reckless breach of contractual obligations which in itself does not yet constitute a fundamental breach may have destroyed the confidence of the other party in the reliability of the obligor, so that the obligee can no longer be expected to be bound by the contract. The official commentary mentions, however, that the principles of good faith and fair dealing contained in Article 1.7. may restrict the remedy of termination, which means that minor violations, even if intentional, may not be sufficient grounds for termination.

The central provision is, of course, lit. (a), a general clause which bases the requirement of fundamental breach on the expectations of the obligee, as crystallized in the terms of the contract, and on their 'substantial' importance for the existence of the contract. This means, first of all, the performance of the respective main obligations and the possibility of such performance. If, for whatever reason, delivery by the seller, construction by the contractor or the services of the professional have become impossible, the other party is 'substantially deprived of what it was entitled to expect under the contract'. If there is only delay, but still a possibility of performance, then the time of performance becomes important as well as the question of whether late performance, as such, meets the requirement of substantial deprivation because time was of the essence of the contract, or whether the obligee first needs to set an additional period of time for performance. There is an additional prerequisite, well known from the CISG, that the obligee's contractual expectations have to be discarded in the evaluation of the obligor's breach if the obligor 'did not foresee and could not reasonably have foreseen' the importance of these specific expectations, a rule which will probably lead to divergent interpretations and different dogmatic characterizations. While the prevailing opinion in the interpretation of Article 25 of the CISG sees non-foreseeability as a kind of excuse, a minority opinion claims that this is basically a burden of proof rule with reference to the importance of the contract term which has been violated because the expectation of the obligee can elevate the corresponding obligations of the obligor to a central 'condition' for the existence or termination of the contract. This in turn requires that the obligor must have known, or at least have had a chance to know, the importance attached to these obligations by the other party in order to agree to its conditional effect at the time of the formation of the contract. Where normal expectations of any obligee in the respective 'shoes' of the parties to the contract are concerned, knowledge and reasonable foresight can always be assumed; but this is different where expectations are unusual and extraordinary. In any case, contractual partners are well advised to make their expectations unambiguously clear, for example by spelling out in the contract properties of goods purchased or objects to be constructed which, even though of no importance for normal use, are so important for the specific aims of the purchaser that their existence should be of the essence for the contract. If, say, the buyer of certain machines wishes these machines to be painted green because they are destined to be resold into a fundamentalist Islamic

country and the buyer's customers insist on such a colour, then the buyer must make clear in the terms of the sales contract the particular importance of this colour for its willingness to contract with the seller; at any rate, the seller has to be advised correspondingly in order to know at the time of the formation of the contract what negative consequences a violation of this contract term could have for the other party.

Finally, the right to terminate is restricted by lit. (e) in the case where termination will cause disproportionate loss to the party in breach because of its preparation or performance.

All this is easy to understand and if one may use the experience gained with the application of the concept of 'fundamental breach' in Article 25 of the CISG quite practical, despite the criticism of some authors who dare not leave the firm ground of their domestic laws and the pronouncements on the termination issue contained therein, and would rather not venture out onto the seemingly bottomless sea of a concept such as 'fundamental breach', open as it is to a case-by-case interpretation and evaluation.

A detailed comparison reveals that Article 7.3.1(2), lit. (b) conforms more or less to Article 108, No. 3 of the OR and to the more specific Article 190 of the OR (*'relatives Fixgeschäft'* in commercial transactions), since the commentary of the drafters gives as an example for the scope of the provision the sale of commodities where the time of delivery is of the essence.[6] Of course, the rule in Article 7.3.1(2)(b) is more extensive than that in Article 108, No. 3 of the OR; it covers express warranties and the tender of documents under letters of credit which must strictly conform with the terms of the credit. Even ancillary obligations, e.g. those restricting the resale of purchased goods or an obligation of the seller/manufacturer not to use the buyer's brand name for goods other than those delivered to the buyer, can be of the essence to the contract.[7] The importance of the obligee's contractual expectations under Article 7.3.1(2), lit. (a) and its frustration by the obligor resembles the *Nutzlosigkeit der Leistung für den Gläubiger* in Article 108, No. (2) of the OR, although the latter provision only covers the frustration of the obligee's contractual

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[6] The official commentary shows, too, that there might be some overlap of the provisions of lit. (a) and lit. (b), since it gives the case where delivery of software has to be accomplished at a certain date as an example for the application of lit. (a).

[7] As an example of a restriction imposed on the buyer to refrain from reselling, see the case of the *Bonaventure jeans*, Court of Appeal, Grenoble, JDI 1995, p. 632 et seq. decided under the CISG; as to an obligation of the seller not to misuse the buyer's brand name *see* OLG Frankfurt NJW 1992, 633. If one restricts Arts. 107, 108 of the OR to synallagmatic exchange obligations, this would probably preclude the application of Art. 108, note (3) of the OR to these cases. There is a minority opinion, however, which puts the emphasis not so much on the synallagmatic exchange character but on the general importance of the obligation breached and would perhaps reach the same results under the OR as would be produced by the CISG and the UNIDROIT Principles; *see* Honsell and Wiegand, Art. 107, note 4 with additional references.

expectations by delay, and not the case of the examples used before of features which are important to the buyer and therefore expressly stipulated (where termination of the sales contract could be obtained by way of Articles 197, 205(1) of the OR), nor the breach of other obligations which are not 'main' obligations in the sense of synallagmatic exchange obligations, but which have been elevated by the parties to become 'of the essence' to the contract.[8] Article 7.3.1(2), lit. (d) partly resembles Article 108, No. (1) of the OR, covering unambiguous refusals of the obligor to perform and the neglect of preparations which will lead to default at the time of performance. But lit. (d) also covers cases which are not regulated expressly in the OR, but would be decided on the basis of analogies, i.e. delay with a part of the performance[9] or non-performance of some, but not all instalments of an instalment contract.

1. Additional Period of Time and Non-fundamental Breach of Contract

The starting point of the system of remedies in the OR, namely that the obligee in an exchange contract first has to set an additional period of time before the contract can be terminated, is also contained in the UNIDROIT Principles, but as a more general fall-back provision. Under Article 7.1.5, the party aggrieved by a breach of obligation of the other party can always set an additional period of time and may terminate the contract after this period of time has lapsed (Art. 7.3.1(3) in connection with Art. 7.1.5). During this additional period of time, the aggrieved party can hold back its own performance and demand damages for the delay, but other remedies are suspended. The obligee can also combine the setting of an additional period of time with notice that after that period of time has elapsed the contract is terminated *ipso facto* (Art. 7.1.5(3)3).[10] The setting of an additional period of time is aimed at making clear whether the non-performance of the obligor is so substantial that it amounts to a fundamental breach and allows termination. As is true for a direct fundamental breach, delay and additional period of time need not concern synallagmatic exchange obligations of the contract, but can be employed for all obligations including the obligation of a seller, contractor or landlord to deliver,

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[8] Whether in these cases under Swiss law Art. 108, note 1 of the OR could be applied cannot be discussed by this author, because this, again, concerns the discussion mentioned in note 6 *supra* on whether only the breach of synallagmatic obligations is covered by Arts. 107, 108 of the OR; *see* Honsell and Wiegand, Art. 97, note 58, advocating a right to terminate in these cases. Under German law, one would assume a *'positive Vertragsverletzung'*, i.e. a general breach of contract, which depending on the importance of the ancillary obligation violated could make it unbearable for the obligee to be bound by the contract, leading to a right to terminate it; *see* MünchKomm and Emmerich (3rd ed., 1994), s. 326, note 103.

[9] *See* Honsell and Wiegand, Art. 107, note 21.

[10] This conforms to the *Ablehnungsandrohung* (notice to refuse acceptance of performance) under s. 326(I)(1) of the BGB, but has more far-reaching consequences, because under the German provision only the claim for specific performance lapses, while under the UNIDROIT Principles the contract as a whole is terminated *ipso facto*.

produce or to let objects conforming to the contract. This, of course, opens up the possibility that minor obligations or insignificant breaches could be blown up to become grounds for termination, and, indeed, Article 7.1.5(3) expressly states that even an insignificant delay allows termination if an additional period of time has lapsed. This, however, should be possible only in case of delay in performing a main obligation because Article 7.1.5(4) excludes termination even after the lapsing of an additional period of time if the obligation breached 'is only a minor part of the contractual obligation of the non-performing party'. This rule should, therefore, prevent any possibility that, by the setting of an additional period of time, insignificant ancillary obligations might become so substantial that termination is possible.[11]

II. Consequences of Termination of Contract

As a consequence of termination, Article 7.3.5(1) provides that the parties are released from their contractual duties. This, of course, does not mean a rescission of the entire contract: arbitration clauses, jurisdiction agreements and other terms which are to operate even after termination, are not affected. The same applies to claims for damages which have arisen as a consequence of the breach of contract (Art. 7.3.5 2)). This is in conformity with the majority opinion as to the effects of termination under German and Swiss law.[12]

A fundamental consequence in case of termination of contracts which have already been performed partly or fully is restitution of these performances, which is provided for in Article 7.3.6. Restitution is aimed at whatever the parties have supplied, and the *quid-pro-quo* character (*synallagma*) of the original contract continues to dominate the restitutionary relationship, too, because restitution has to be made 'concurrently'.

If restitution in kind is not possible or 'not appropriate', recovery 'should be made in money whenever reasonable' (Art. 7.3.6(1)2). The commentary explains the restriction 'whenever reasonable' as a consequence of an assumed basic principle of unjust enrichment: if the performance received is valueless for a recipient who, therefore, is not enriched (no benefit is conferred), there should not be any obligation to pay anything if restitution in kind is not possible, e.g. in case of services. It should be added that, if the recipient would have had to pay for the services anyway, there is enrichment in so far as expenditure is saved, so that restitution in money should be regarded as 'reasonable' under unjust enrichment principles.

In the case of long-term contracts with divisible performances, the contract is kept alive in respect of performance made in the past; restitution can only be claimed for performance made after termination (Art. 7.3.6(2)). Corresponding proposals for

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[11] Perhaps it would have been better to include the restriction of Art. 7.1.5(4) in Art. 7.3.1(3).

[12] As to Swiss law, *see* Honsell and Wiegand, Art. 109, note 4 describing the so-called *Umwandlungstheorie*.

Swiss law can be found in the case of the much treated problem of termination of *Dauerschuldverhältnisse*, i.e. long-term contracts under which remuneration is paid according to the duration of the contract, e.g. leases and contracts of service.[13] Under Article 7.3.6, as well as under Swiss and German law, cases in which termination should exceptionally extend to performances already exchanged because of a close interdependence of the performances[14] could be solved under Article 7.3.6. as under Swiss and German law by the requirement of 'divisible' contracts: if there is a close connection between performances, the contract cannot be divided into a valid part performed in the past and a part terminated for the future.

Article 7.3.6 will have to be taken up again critically later, but at this point it is already necessary to remember the parallel provision for cases of invalid or voidable contracts, which has been dealt with by Professor Kramer in this issue. Article 3.17(1) provides for general retro-activity of avoidance, so that even in the case of long-term contracts, past performances have to be fully restituted. While paragraph 2 contains a similar provision for concurrent restitution *in specie*, the wording for the additional provision regulating the case that restitution in kind is not possible deviates from Article 7.3.6(1) in so far as in the latter case the party concerned has to 'make an allowance'. The case where restitution in kind is possible but 'not appropriate' is omitted in Article 3.17, and the restriction 'whenever reasonable' is also missing in the case of restitution triggered off by avoidance. Finally, Article 3.17 provides for restitution only in case of avoidance, but not in other cases of invalid contracts. Since Article 3.1 exempts certain cases of invalidity, lack of capacity, lack of authority and immorality or illegality from the scope of the UNIDROIT Principles, it is questionable whether restitution in these cases is governed by the law determined under conflict-of-law rules of the forum, whether this leads to the law which invalidates the contract, or whether the restitutionary rules of the Principles may be applied by way of analogy or gap filling. Since Article 3.2 bases contracts on the mere agreement of the parties, one has to assume that invalidity of a contract because there was no agreement, e.g. in cases of delayed acceptance under Article 2.9 to which the offeror objects, or in cases of a modified acceptance not counter-accepted by the offeror under Article 2.11(1) has to be regarded as invalidity governed by the UNIDROIT Principles, so that it could be argued that, at least in these cases, restitution has to take place under or be analogous to Article 3.17(2). The question could be disputed, however, since Article 3.17(2) mentions expressly only the case of avoidance, and it could be argued, therefore, that invalidity in all other cases is governed by the law determined by conflict-of-law rules of the forum. This requires first, to know which conflict-of-law rules are dealt with followed by the even more difficult problem of which law governs restitution. In particular whether restitutionary remedies are exclusively covered or whether property remedies such as

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[13] *See* Honsell and Wiegand, Art. 109, note 10 (instead of termination *ex tunc* there is no termination *ex nunc* '*an die Stelle des Rücktritts tritt ein Kündigungsrecht*').

[14] *See* Honsell and Wiegand, Art. 109, note 110.

the *rei vindicatio* have to be included because under the applicable law of the *lex situs* invalidity of the contract may cause the title in the goods to fall-back to the seller, as it does, for example, under French law.

Another questionable shortcoming of Article 3.17 of the UNIDROIT Principles is the fact that restitution is generally independent of the reasons for avoidance. If applied literally, this would mean that even in case of *laesio enormis* (Art. 3.10) or in cases of fraud or threat (Arts. 3.8 and 3.9) the party to blame can demand full restitution; there is no bar to its restitutionary claim because of the maxims *nemo auditur* ... or *in pari turpitudine* .... A usurious lender, therefore, would not run any risk, because the worst that can happen is avoidance which makes it possible to claim back the loan by way of restitution under Article 3.17.[15]

III. Adjustment of Contracts because of Hardship (Wegfall oder Veränderungen der Geschäftsgrundlage)

Section 2 of chapter 6 provides, after an admonition that even onerous contracts must be kept and performed (Art. 6.2.1),[16] rules for a situation well-known in the Germanic legal systems as *Wegfall oder Änderung der Geschäftsgrundlage* (Arts. 6.2.2 and 6.2.3). Under these provisions, a party struck by an extraordinary event ('hardship') can ask for renegotiations (Art. 6.2.3(1)) and, if these new negotiations fail to lead to an agreement within a reasonable time, the disadvantaged party can resort to the court, which may either terminate the contract or adapt its terms in order to restore its equilibrium (Art. 6.2.3(3) and (4)). Prerequisites for this further intrusion into the principle of *pacta sunt servanda* are described rather generally in the first place as a fundamental distortion of the equilibrium between performance and counter-performance, caused by a certain event, be it that the costs of a party's performance have increased or that the value of the counter-performance has diminished. But these rather general requirements are qualified by the following, more detailed provisions, which state as prerequisites that the event must have occurred only after the formation of the contract, or that the event must have become known after this date (Art. 6.2.2, lit. (a)), that it could not have been reasonably taken into account by the disadvantaged party at the time of the conclusion of the contract (lit. (b)) and was beyond the control of the disadvantaged party (lit. (c)), and that it did not belong to the risks which were assumed by the

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[15] A solution could be to adjust the usurious interest under Art. 3.10(3) to the interest rates generally charged in a comparable market. This, of course, covers only avoidance for *laesio enormis*, but not other cases such as fraud or duress. An extension would require the development of a general principle to develop a gap-filling rule under Art. 1.6(2).

[16] Where the performance of a contract becomes more onerous for one of the parties that party is nevertheless bound to perform its obligations subject to the following provisions on hardship, a solution for the situation which in the Germanic laws is known and familiar as *Wegfall oder Änderung der Geschäftsgrundlage* (discontinuation or change of the basis of the bargain), Arts. 6.2.2 and 6.2.3.

disadvantaged party under the contract (lit. (c)). For a Swiss or a German jurist, this is a reminder of the respective formulas developed in Switzerland on the basis of ZGB, Article 2, and in Germany on the basis of BGB, section 242, and, perhaps even more precisely, a Swiss lawyer may be reminded of Article 373(2) of the OR, under which provision an increase in the price or a termination of a construction contract can be granted by the court if extraordinary circumstances which could not have been foreseen or which were unthinkable under the facts assumed by both parties hinder the completion of the work or make it unreasonably onerous (*'falls ... außerordentliche Umstände, die nicht vorausgesehen werden konnten oder die nach den von beiden Beteiligten angenommenen Voraussetzungen ausgeschlossen waren, die Fertigstellung hindern oder übermäßig erschweren ...'*). German jurists will be reminded of a provision in the law of leases which allows adjustment of the rent if 'after formation of the lease contract the circumstances which were decisive for the fixing of the party's obligations have changed lastingly, so that the concurrent obligations have become grossly disproportionate'; the risk of efficient management of the land, however, is excluded from this remedy of adjustment. A lawyer from one of the Germanic law countries can have no objections against the legal fixing of such a rule, and the drafters of the Principles have to be admired for having succeeded in persuading their colleagues from France to give up the theory of *imprévision*, which prevents the civil courts from taking into consideration a change of circumstances. Neither the decisive requirement for an adjustment of a contract, i.e. that there is a grave distortion of the equilibrium of performance and counter-performance[17] which was unforeseeable[18] and could not have been controlled by the disadvantaged party and, in addition does not belong to the risks assumed by it as is the case in regard to the intended use of purchased goods nor the adjustment in itself will be likely to provoke criticism in Switzerland or Germany.

B. Evaluation

Every analysis and evaluation of the solutions offered by the UNIDROIT Principles first needs to consider who the readers of the Principles are and who is to be expected to apply them. The regulation of duties and rights of the parties always subsidiary to the agreements reached by them is addressed primarily to the parties themselves and supplements the gaps in the contract left open by them. If something goes wrong, the Principles contain Directives for the parties, i.e. they tell the parties what to do, what the legal consequences may be, and what steps have to be undertaken to secure their respective rights and interests. But together with the remedies of the parties another

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[17] As to Swiss law, *see* Honsell and Wiegand, Art. 18, note 104.
[18] *See* Honsell and Wiegand, Art. 18, note 101.

addressee comes into the picture, namely the deciding body (be it an arbitrator or an arbitration court, or a state court) which will have the last word in regard to a party's remedies. Here, though, the difference between arbitration tribunals and state courts, arbitrators and judges, of whom the latter have a specific legal education and are influenced by their profession, can influence the language and density of a regulation: if it is applied primarily by arbitrators, who are often less interested in dogmatic niceties and in the structural consistency of a legal system, but are instead guided by practical and pragmatic considerations, the regulation should be 'cut' rather loosely, operating with open concepts and leaving room for discretion. If, however, norms have to be applied by state judges, then, at least under the German tradition, it is expected that such norms are worked out rather precisely and concretely. The Principles seem to be a rather loosely cut 'robe', because they frequently employ discretionary concepts such as 'reasonable time', 'importance' (of a mistake), 'unjustifiable' (advantage) or 'not appropriate' (restitution in kind). These discretionary concepts need to be applied and narrowed taking into account the facts and circumstances of the concrete case. Such a technique of regulation may be criticized because the results are less predictable. However, it seems to be unavoidable when one takes into account the object of regulating international contracts and problems in performing them and, in particular, the main addressees.

A loosely 'cut' norm which allows discretionary evaluations when taking into account the circumstances of the concrete case is very difficult to criticize since the results of its application cannot be predicted, so that this familiar and proven method of checking the 'correctness' of the legal solution is not applicable here. Nevertheless, I shall dare to put forward some critical questions concerning the Principles despite my admiration for their drafting and their drafters, if only in the hope of inducing a discussion which might reveal that I have misunderstood them. In addition, a critical analysis may be justified as an aid for practitioners in drafting contracts: if it can be shown that open concepts and phrases inviting discretionary evaluation in the field of restitution may cause unpredictability, the following considerations may be understood as a warning to the parties that they better draft concrete terms and provisions calibrated to their special needs and circumstances for their contract, instead of relying on the loosely drafted provisions of the Principles.

I. Termination

The right of the obligee to terminate a contract in the case of 'fundamental breach' or lapse of an additional period of time may cause the danger for the obligor that the obligee delays termination and speculates, watching the development of the market, at the expense of the obligor in breach. In the Hague Sales Convention (ULIS) of 1964, this danger was prevented by provisions under which an *ipso facto* avoidance of the contract took place where the obligee could conclude a cover transaction on the market without difficulties. Under the German BGB, the obligee loses the right

to specific performance after the additional period of time has lapsed.[19] But such a chance to speculate by delaying election between a claim for specific performance and termination of the contract (in connection with damages) is largely cut off by Article 7.3.2(2), which requires termination in case of delay or non-conformity to be made within a reasonable time after the obligee has or ought to have become aware of the delay or the non-conformity. Similarly, this must apply likewise to the anticipatory breach covered by Article 7.3.3, a position which under German law has caused some discussions as to the decisive date for the computation of damages. As to the CISG, the prevailing opinion there also claims that termination has to be declared within a reasonable time.[20] Finally, an unreasonable delay between breach and the notice of termination by the obligee which causes an increase in damages could be countered by the obligor by making use of Article 7.4.7, with the effect that the amount of damages is reduced to the extent that the delay of the obligee was a contributing factor to it.

As can be inferred from the provisions on the consequences of termination, this remedy is construed as a 'formative right' (in German: *Gestaltungsrecht*) of the obligee, i.e. a right the exercise of which changes the legal situation by the legal effect of the respective notice. Whether the formative notice of termination, which under Article 1.9(2) becomes effective on receipt, is final or could be withdrawn by the declaring party is an open question. This means, however, that the problem discussed frequently in Switzerland in regard to the remedies of a buyer in case of non-conformity (a problem which arises in Germany as well thanks to the misbegotten alternative of termination and damages, namely the problem of a *ius variandi*), may arise under the Principles, too.[21] In other words: can the obligee who has sent notice of termination later withdraw this communication in order to revert to a remedy for specific performance in connection with damages? It would have been helpful if a text as modern as the UNIDROIT Principles had contained an unambiguous answer to this question. In regard to the CISG, I have tentatively proposed[22] to retreat from the dogmatic position that the effective exercise of a 'formative right' changes the legal situation definitely and that, instead, withdrawal or modification of a termination and other formative notices should be allowed as

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[19] *See* s. 326(1)1 of the BGB; cf. Art. 107(1) of the OR. In applying Art. 107 of the OR the question treated here may be raised in connection with the amount of damages where the obligee foregoes the remedy of specific performance and asks for damages, cf. Honsell and Wiegand, Art. 107, note 19; this must apply to damages under Art. 109(2) of the OR claimed in addition to termination, too.

[20] But *see* Schmidt-Kessel, (1996) *RiW*, at pp. 60, 62.

[21] Cf. to Art. 205 of the OR Honsell and Wiegand, note 3 with further references for the opinion that if the buyer's remedies are characterized as 'formative rights' the right to choose between different remedies is lost on exercise of one of them; as to the irrevocability of a termination of a construction contract *see* BGE 109 II 41.

[22] *See* Schlechtriem, 'Bindung an Erklärungen nach dem Einheitskaufrecht', in *Emptio-venditio inter nationes* (FS Neumayer, Basel, 1997), at p. 259.

long as the recipient has not yet acquired knowledge of the notice or not yet acted in reliance on its effects. In regard to the UNIDROIT Principles one might have to make use of the gap-filling rule in Article 1.6(2) in order to derive a similar principle by drawing on the provision on revocation of an offer (Art. 2.4).

1. Termination and Adjustment of Contracts

The use of open concepts in the Principles allows flexibility, but may cause some inconsistency with the rigidity of clear consequences of certain norms in certain situations. It seems that the provisions for adjustment of a contract and those which allow its final termination because of a fundamental breach are an example for such a contradictory relationship. A possible reason might be that the instrument of adjustment because of severe disturbances ('hardship') is a rather modern concept which is by no means self-explanatory to all jurists in all legal systems, and whose integration into the Principles might have been a great concession by the representatives of certain legal systems. On the other hand, avoidance of a contract for mistakes or termination because of a breach are both part of a common legal heritage, which might be seen as traditional and familiar were there not grave differences between the legal systems, especially, as mentioned before, with reference to the question whether termination can be brought about by notice of a party on its own or, at least in principle, only by court decision. While older codes are based on the priority of avoidance or termination of a contract by court decision, more modern and progressive codifications allow avoidance of a contract for mistake or termination for non-performance by simple notice of a party. This makes the contradiction mentioned above evident: if the argument between the parties over existence or termination of a contract, very often in the course of which possible adjustments may be discussed, always leads to a court decision, then the court as the last and only arbiter can finally decide over this or that solution. However, if the contract has been terminated already or avoided by notice of a party, then the two solutions can clash if the same reasons which allow adjustment because of hardship would also allow termination. If, for instance, the sales contract concluded in the spring contains an obligation for the seller to deliver the goods (Sudanese cotton, say) on 1 October sharp, and in September a political disorder or civil war causes a closing of the Suez Canal so that the cotton cannot be shipped to London in time, the buyer is entitled to terminate the contract for anticipatory non-performance under Article 7.3.3 at once because it is clear that the delivery date cannot be kept and that, the delivery date being of the essence of the contract, there will be a fundamental non-performance. This poses the following question: may the seller, despite the effective termination, resort to Article 6.2.3 and request renegotiations, perhaps offering to accept a price reduction for the delay, as the closing of the Canal would certainly be a case of hardship under Article 6.2.2? Can a collision between anticipatory and 'formative' termination of the obligee and the request to renegotiate by the obligor be avoided? This should be possible if one carefully uses the proposal made above to restrict the formative effects of a notice of termination until the point

where the recipient has knowledge and fails to demand renegotiation without delay. In addition, the obligee terminating the contract would violate the principle of good faith and fair dealing by denying a justified demand for renegotiation by the obligor and referring to the formative effects of the notice of termination instead. As the comments of the drafters and their examples show, Article 1.7(1) allows a principle of estoppel or *mißbräuchliche Rechtsausübung* to be derived from the provisions of the Principles.

II. Detailed Issues as to Termination, Avoidance and Voidness

1. Termination after Avoidance

If the termination or avoidance of a contract is left to the discretion and competence of a court which can evaluate all the circumstances of the case, then certain problems following from the restitution of performances under the void or terminated contract are more easily solvable because the court can take them into account when deciding on the request for avoidance or termination. If, however, the contract is avoided or terminated by notice of one party, then the consequences of restitution become more important and may develop into contested issues, for example where performance and payment have been made but full restitution in kind is impossible.

As mentioned before, the Principles have drafted rather loose provisions for restitution after avoidance or termination since in case of avoidance 'either party may claim restitution of whatever it has supplied under the contract ..., provided that it concurrently makes restitution of whatever it has received under the contract ... or, if it cannot make restitution in kind, it makes an allowance for what it has received' (Art. 3.17(2)). Also, in the case of termination because of a fundamental breach, the comparable provision reads that 'either party may claim restitution of whatever it has supplied, provided that such party concurrently makes restitution of whatever it has received. If restitution in kind is not possible or appropriate allowance should be made in money whenever reasonable' (Art. 7.3.6(1)).

The risk of loss in case of restitution after avoidance (Art. 3.17(2)) disregards the reasons which have caused avoidance. The avoiding party has to make 'an allowance' if it cannot restitute in kind, even if it has become the victim of a fraud. It needs to be remembered, however, that Article 3.17 was drafted rather early and never discussed extensively, while the reasons for avoidance and the various scenarios in this context were the topic of extensive discussions and many amendments in the several drafts. Therefore, one has to assume that the reasons for avoidance and the consequences of avoidance were not treated simultaneously and thus were not co-ordinated. An even more difficult issue could be restitution in the case of invalidity of a contract, if domestic laws, determined by the conflict-of-law rules of the forum, offered different solutions in the case of, e.g. situations where restitutionary claims are barred by the Roman maxim of *nemo auditur proprium turpitudinem* and similar rules.

It remains to be seen whether and how Article 3.17 can be applied in such a way

that contracts partly performed in the past are not fully avoided retroactively, in other words, whether the solution of Article 7.3.6(2) can also be read into Article 3.17. The rule under German law for certain long-term contracts that avoidance terminates only *ex nunc*, the recurring idea of 'factual contracts' to avoid restitution and unsatisfactory estimates of the value of the allowances to be made and similar solutions come to mind, but these cannot be discussed in any detail in this context.

2. *Restitution after Termination*

In the case of termination, too, a lack of co-ordination between the reasons for termination and its consequences in the provision for restitution is obvious. The obligation to restitute in kind or to make an allowance in money puts the risk of restitution on each party, irrespective of the reasons for termination of the contract and/or the perishing of the object which has to be restituted. The restriction that an allowance in money is owed 'whenever reasonable' may, however, be broad enough to allow considerations of responsibilities for risks created by an obligor to be taken into account. The history of the provision shows, however, that it is motivated only by an attempt of the drafters to achieve more precision in the English version in regard to the computation of the allowance. A doctoral thesis written under my supervision, therefore, proposes to use this phrase ('whenever reasonable') in cases where the destruction or deterioration of goods in the hands of the purchaser can be attributed to the sphere of risk of the seller, for example where non-conforming features of the goods sold which gave rise to the termination of the contract have also caused the perishing of the goods.[22a] This, of course, provokes the question whether it might not be appropriate in any case to calibrate the allowance owed by the obligor of the restitutionary obligation according to the responsibility of the other party for the reasons on which termination was based.

In view of the great variety of possible scenarios, one should remember the observation made earlier, that the drafting of rules on the consequences of avoidance or termination should leave enough discretionary leeway for judges and arbitrators to take into account all circumstances of the individual case. This applies, in particular, to the phrase 'whenever reasonable'. Nevertheless, it may be expected and indeed be useful to search for some hints in other provisions of the Principles which might offer help in answering questions which so far have been covered by this phrase.

To the extent that the obligor of the restitutionary obligation is responsible for the impossibility of restitution, the reference of the drafters in their comment to the general rules for specific performance that the 'reasonable allowance in money' in such a case could be computed like a claim for damages for non-performance under Article 7.4.1 *et passim* may turn out to be helpful.[23] In any case, the responsibility of one party

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[22a] Hornung, *Die Rückabwicklung gescheiterter Verträge nach französischen, deutschen und nach Einheitsrecht* (Baden-Baden 1997) p. 153.

[23] *See* Commentary note 4, at p. 192.

for the reason for termination may give rise to a claim for damages which can be taken into account in the general balancing of the mutual restitutionary 'allowances'.

The use of the general provisions on damages and their application in regard to the restitutionary obligation in case of impossibility of full restitution may also allow solutions for the determination of the relevant date for the computation of the allowance: if the obligor of the restitutionary obligation is responsible for the impossibility of restitution, then the allowance will usually have to be 'full compensation' in order to be reasonable. In case of destruction or deterioration by *force majeure*, however, the value at the time of the performance should be decisive. Any imbalance in the value of performance and counter-performance resulting from such a determination of the value is unavoidable since the same would apply in case of restitution in kind. The party which has delivered an inferior performance for a more valuable counter-performance would get back its inferior object against restitution of the excessive price.

No privileges for the innocent recipient, who may have squandered the sales price received, are provided for in the Principles; they would be inadequate as a general rule in international commercial contracts anyway. The provision that restitution has to be made 'concurrently' also shows that an innocent recipient will not be privileged in the case of avoidance or in the case of termination. Whether in the latter situation the concept of 'reasonable' allowance in Article 7.3.6(2) (which is absent from the provision for restitution after avoidance) offers more leeway or whether the relief mentioned above in the case of valueless performances which cannot be restituted in kind might be generalized in line with the view of the drafters that it is an instance of a general principle against unjust enrichment cannot be treated here in depth; at the least, no difference should be made between the two situations where restitution takes place, i.e. avoidance or termination.

Unfortunately, no complete provision for the restitution of the value of having the use of the performances to be restituted has been made. However, Article 7.4.9 requires that interest must be paid on all money debts, so that at least the use of capital that has to be restituted will be compensated. It is, therefore, arguable that the advantage of the use of other kinds of performances should be compensated, too, admittedly only if there was such a valuable use. The reference of the drafters in their commentary to the CISG, which in Article 84(2) provides for such a solution, may be used as an additional argument for this.[24] The possibility of grave disadvantages following from such a rule for the innocent recipient, who might have to compensate for the use of many years, could be avoided under Article 7.3.6(2) at least in case of termination, where retroactive restitution of divisible performances and, by the same token, of the use of such performances is excluded. A similar rule should be considered for restitution on account of avoidance and invalidity.

Provisions or even references which take into account improvements made by the

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[24] *See* Introduction, at p. VIII.

obligor of the restitutionary obligation to objects to be restituted are entirely absent. In so far as the other party is responsible for the termination or avoidance, one could help with a claim for damages. Improvements which become useless for the obligor of the restitutionary obligation may be claimed as damages. If termination occurs on account of a breach for which the party in breach might be excused, the risk of useless improvements should stay with the obligor of the restitutionary obligation. Where removal and retention of the improvements are not possible, one might further advocate, if need be, a rule on the basis of the general principle that no party should be unjustly enriched to the effect that a reasonable allowance as compensation for the improvement could be paid. In the compensation's computation the question of reasonableness becomes of particular importance, however, in order to avoid the compensation of unwanted improvements which are useless for the obligee of the restitutionary claim.

The question of compensation for use and improvements unavoidably leads to an issue which has been avoided in the preliminary remarks of this article because it cannot be treated sufficiently here. Avoidance of a contract in many legal systems, although not under German law, causes an *ipso iure* re-transfer of the title in property delivered to the other party. In France, this takes place even in the case of termination of a contract, and the effects on the title of a *résolution* were used for many years, until retention of title was legally recognized, as a security for the seller in case of bankruptcy of the buyer. In case of a re-transfer of title, could the *Vindikation*, i.e. the property claim of the seller, be defeated by the buyer under Articles 3.17 or 7.3.6(1), unless the owner offers restitution of the price concurrently? Whether such a property claim as the *vindicatio* can be granted has to be decided by the *lex situs*. If the *lex situs* provides for a retransfer of property and thus for corresponding property claims against the possessor, then the situation of the owner in regard to other creditors of the obligor of the restitutionary obligation, in other words, the immunity of a claim in case of bankruptcy of the debtor, as well as the question of improvements and compensation for use as side effects of a vindication have to be determined according to the respective domestic law. The flexible phrasing of Article 7.3.6(1) allows adjustments to many issues, but it is mute and without any guidance as to the concurrence of actions and the problems of bankruptcy of the obligor of the restitutionary obligation. The answers, however, could not have been given by the drafters of the Principles. This would have meant that despite the party choosing to have their contractual relations governed by the Principles, it would also have been intended and legally possible for them to choose the applicable property law; this, however, would have exceeded the mandate of the drafters of the Principles, who would have had to analyse the property laws of all legal systems in order to know whether they are *ius cogens* or could be modified by autonomous agreement of the parties. That they have not done so for good reasons may be used as a justification not to pursue this issue any further.

C. Final Remarks

No system of legal provisions, be it drafted by a legislator, by a group of experts or by lawyers while negotiating a contract, can ever be complete. Parties choosing the UNIDROIT Principles have to accept, as they have to do when state law is applicable, that some issues are not sufficiently and precisely regulated, or are regulated in a way which does not conform to their interests. A legal adviser who recommends that his client chooses the UNIDROIT Principles instead of a domestic law to govern an international contract will, however, rarely give this advice in an unqualified manner, but will think about and explain why the UNIDROIT Principles should be recommended and preferred over other legal regimes. This choice does not merely reflect the conviction that domestic legal systems in question show signs of ageing and, therefore, seem inappropriate for international commercial contracts, and which are accessible only with great difficulty because of a jungle of case law and academic theories. In formulating considerations and advice, a legal counsellor will check the Principles point by point so as to determine whether and to what extent they conform with the client's interests and expectations. Where they do not, changes and amendments will be advised, thus proposing more concrete and clearer terms even for those parts of the contractual regime where the provisions of the Principles could be regarded as too loosely drafted. The Principles, therefore, also serve as a kind of checklist which states the points that are to be considered and, if need be, drafted individually. In other words, they are a handbook for the drafting of contracts for international commercial dealings. I have pointed out some, perhaps only hypothetical, shortcomings, bearing in mind just this use of the Principles: practitioners who advise clients on contracts under the UNIDROIT Principles should be alerted to points which strike, at least a theorist such as myself, as problematic.