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International Institute for the Unification of Private Law

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WORKING GROUP FOR THE PREPARATION OF  
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

Chapter [...]

SET-OFF

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## SET OFF

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The development of international commercial trade has created an assortment of contractual interrelationships. It is no longer unusual for a party to find himself being at the same time both the creditor and the debtor to another party. The question arises whether the debt owed and the debt owing should be considered independent of each other, with each debtor obligated to perform without taking in account the existence of the debt owed to him, or whether one may consider the two debts linked because of their reciprocal nature ?

Various legal systems recognize the doctrine of “set-off”(or compensation) which links the reciprocal debts of two parties, thereby avoiding the need to make two overlapping payments. But the concept of the “set-off,” as well as the scope of its applicability, differs radically in different legal systems.

There appears to be three principal justifications for permitting debts to be set-off against each other, each of which corresponds to a different notion of set-off.

One may view a set-off as merely serving the practical, concrete concern of simplifying the relationship between a debtor and a creditor. In this view, a set-off avoids the necessity of the two parties transferring funds to each other. Under this view, a set-off is created “ ipso jure ”, automatically, by operation of law, when there are two reciprocal debts fulfilling certain strict prerequisites.

One might also view the set-off as a means to avoid the injustice that might result if a debtor could refuse to pay a debt, while at the same time he could force his own debtor to pay his debt. One party would pay and the other would not. In this case, it would be up to the courts to decide whether forcing the second party to pay would be unfair in a given case.

Finally, the recognition of a link between two reciprocal debts, permitting a debtor to reduce his debt to his creditor by the debt which is due to him by this same creditor, leads to a situation where the creditor is in a better position vis-a-vis the debtor's other creditors. The creditor is better off because he can be paid via the set-off. In this view, the set-off is a form of security for the benefit of a party who is at the same time both creditor and debtor. In this case, the debtor is free to claim the set-off , merely by an informal declaration, he has to inform the other party of his choice to satisfy the debt owed to him by applying the set-off.

One might categorize these three different notions of set-off held by different legal systems as respectively: “set-off ipso jure”, “procedural set-off” and “set-off by declaration ”.

Looking into history and comparative law we find examples of how these different views have been adopted by different legal systems:

I - The Different Notions of Set-Off. ( comparative law)  
Procedural or substantive nature of set-off ?

Before attempting to find principles for the application of set-off in international business contracts, it seems appropriate to restate briefly the different justifications for the set-off.

a) In **Roman Law**, the concept of the set-off developed only gradually. At first, the right to assert a set-off was based upon the contractual intent of the parties. Thus, it was necessary for the parties, already relating, to provide in a contract that they intended to extinguish by set-off their mutual obligations. Then it was possible to assert a set-off as an affirmative defense, which permitted a judge to cancel out reciprocal obligations of the two parties.

Under Justinian, set-off applied “ipso jure”, apparently meaning that a plaintiff could demand payment of a debt for the amount which rests after his reciprocal debt was deducted as a set-off. It does not appear that “ ipso jure ” meant that the set-off would exist par operation of law, automatically, at the creation of the second debt.

b) The Justinian conception, adopted in the jus commune had influenced ( with a false interpretation) the **French Civil Code**. It opted for a concept of the set-off by which it takes effect automatically, by operation of law. (Article 1290 du code civil : “ La compensation s’opère de plein droit, par la seule force de la loi ”) In essence, the set-off is merely a method of payment.

The set-off operates “ipso jure”. It is automatic and obligatory, depending solely upon the law . This conception emphasizes the desire to avoid the necessity of two separate payments and to simplify the performance of obligations A consequence of the automatic set-off is the requirement of strict conditions

This conception of set-off has served as the model for Italian, Spanish, Quebec and Latin American law.

Thus, is not to say, that French law does not also recognize procedural set-off (compensation judiciaire), as well as set-off agreed by contract (compensation volontaire).

From the moment parties enter into the second of the two reciprocal obligations, assuming certain prerequisites are met, the two debts are reduced in an amount equal to their difference. The extinction of the debts takes effect by operation of law, without any intervention by the parties. The “ipso jure” conception strives to avoid the discretion of a judge intervening.

But the “ automatic ” effects of the set-off can be mitigated, since the set-off is not a matter of public policy (ordre public). If a creditor does not want to assert the set-off, it cannot be invoked ex officio (d’office) by the judge

c) **German law** has elaborated its own theory of set-off, independent of Roman Law. In Germany, the set-off is basically a voluntary act, an election by a party who seeks to take advantage of it. It is, a means of securing a debt and it may or may not be exercised by one against whom demand for payment is made.

All the rules of the BGB relating to set-off confirm this view of the set-off as a form of securitization of debt.

The distinctive feature of German law is that, when the required conditions are met, the party who demands payment -- or of whom payment is demanded -- is able to unilaterally declare that his debt is extinguished by a set-off. This declaration is extra-judicial and no particular formality is required. Neither party is obliged to make the declaration. Each may do so or not do so, according to his individual interest. A party may choose, to wait to make the declaration, to assert the set-off against a different debt or to not assert the set-off at all, for whatever reason. The unilateral declaration, is useful because it informs one party of the other’s intent to call upon the set-off. It allows also to specify the particular debt that one wishes to extinguish if the creditor is owed several debts by the debtor.

Set-off by declaration is also adopted in Dutch law

d) The notion of the “procedural set-off” is recognized today in **Common Law** countries. According to the most reliable authorities, the set-off in England arose as a purely procedural device. It was up to the courts to decide whether two reciprocal debts could be set-off against each other. It is notable that the concept of set-off was developed in England in the Court of Equity. At the beginning of the 18th century, two laws which were passed, related to bankruptcy (the Insolvent Debtor’s Act of 1729 and the Debtors Relief Amendment Act of 1735), envisaged the possibility that “one debt must be set against the other.”

Applying these two laws, the Chancellor developed in the Chancery Court, a body of rules, “equitable set-off”, which would later be applied in a variety of different situations.

Under the Common Law, set-off is best viewed as “procedural” even if judges may, and almost always do, search for an implied agreement by the parties demonstrating their intention to set-off their reciprocal debts. Theoretically, set-off is a procedural defence, granted by the court if the required conditions for applying the set-off are satisfied. It is up to the judge to decide if it is just and fair, for a defendant, to deduct the debt owed to him by the plaintiff as a set-off against the plaintiff’s claim. As it is the judge who decides whether set-off is appropriate, the set-off takes effect only when the court’s judgment is issued. The set-off does not apply retroactively.

Modern scholars suggest that English Law is gradually moving away from the notion of the set-off as a procedural device toward a notion of set-off of a substantive nature.

e) In the framework of this report, which is intended to offer a set of rules governing set-off to be adopted for international contracts, it would seem necessary to select among the three theoretical conceptions of the set-off. But, one may say that no country has adopted any of the three conceptions in its purest form. In practice, the three concepts are not so different, and certain rules found in each system seem to derive from the others

Bearing all of this in mind, we will consider the most appropriate legal basis upon which to establish a uniform set of rules for application of set-off in international contracts.

In the UNIDROIT Principle it would seem to be difficult to consider set-off as a procedural device. To adhere to the judicial set-off would require integrating the notion of set-off in the procedural rules of the various nations. Set-off would not, then, be an appropriate subject for principles governing international contracts. Each country is master of its own courts' procedures. The rules of civil procedure are best left to each individual court system.

Thus, it seems that we must look to one of the other notions, where set-off is regarded as a matter of substantive law.

Nevertheless, the role of the courts will be very important, whatever substantive rules are chosen, even if these rules are chosen to minimize the disputes that will inevitably be presented to the courts. There will always be a judicial aspect to set-off, but the power of the courts will be more or less extensive, depending on the notion chosen.

## II - Set-off ipso jure or by declaration?

Assuming that one rejects the notion of the set-off as a procedural remedy and focuses instead on the civil law notion of the set-off as a matter of substantive law, it is necessary to establish whether set-off will automatically come into existence or be created upon the declaration of one of the parties.

At first glance, the differences between these two concepts seem rather important but in practice they are reduced

a) If the set-off operates automatically, by operation of law ( de plein droit), the two parties have no role to play. The set-off is applied without their

participation, the two debts are extinguished without the knowledge of the parties (“à l’insu des débiteurs”)

Many consequences flow from the “automatic” nature of the set-off and some strict conditions are imposed.

But one must immediately mitigate the automatic nature of the set-off by stating another, more general, rule (which does not arise from the rules relating to set-off): a legal right must be raised by a party to be given effect. This general rule is applicable to set-off. The courts cannot apply a set-off *ex officio*

The debtor who has been sued for payment of a debt, must pay if he fails to raise the set-off as a defence. The right to the set-off, if not affirmatively asserted, is waived.

But once the debtor has raised the defense of the set-off, thereby demonstrating his intent to refuse to pay the debt other than by set-off, the automatic nature of the set-off comes into play. The court has no power to assess the fairness of the set off. The court may only consider whether the legal prerequisites has been satisfied and, if so, the court must apply the set-off.

b) In set-off by declaration, the set-off is a voluntary act. One party makes to the other a declaration that he wishes to assert a set off. The set-off is created by the declaration.

The voluntary declaration has the advantage of informing the other party of the intention of the debtor to assert a set-off, out of court. An informal declaration is sufficient. Set-off had not to be pleaded in court.

Thus, in drafting the proposed Unidroit Principles for set-off, one must consider whether to recommend that parties seeking to assert a set-off must make an express and voluntary declaration out of the court, even if this is more of a question of concept and underlying justification than of practical results.

It seems that perhaps a rule requiring a voluntary declaration of set-off would be preferable in the business world. It has been argued ( Zimmermann, first draft) that informal declaration facilitates the exercise of a right of set-off, that is based upon the general principle of good faith, and leads to a practical simplification in the implementation of payments

If a declaration of set-off is made, according to certain flexible formalities, the intent of one party to pay his debt via the set-off, would be, more official vis-a-vis the other party and third parties. This seems to provide some degree of certainty for all of the interested parties, since the intent of the debtor to make payment, in the form of the set-off, has been made known. With respect to third parties, if the set-off is in their interest, the set-off should be binding as soon as the date of the declaration, (which could be made by notice)

Even if in theory there is a great difference between a set-off ipso jure and a set-off by declaration, in practice, there is no great difference between a requirement, that one declare one's intent to set-off a debt, and the obligation that one affirmatively invoke in court a set-off that has already been created by operation of law. Moreover, the requirement of a declaration seems to be advantageous because the date of the creation of the set-off is easily known.

**So, it seems that the first article of the UNIDROIT Principles on set-off will express that set-off is of substantive nature and that a declaration of set-off has to be made**

The text proposed by The Lando Commission (very near from the § 387 of BGB) corresponds also to a set-off of substantive nature, with a declaration:

Zimmermann draft:

“If two parties owe each other obligations of the same kind, either of them may set-off his claim against the other party's claim, if and to the extent, at the time of set-off

- a) he is entitled to effect his own performance and
- b) he may demand the other party's performance ”

This article contains some conditions which must be fulfilled to assert the set-off. So it is difficult now to propose a draft for article of UNIDROIT Principles, stating set-off by declaration, before we discussed the conditions imposed for set-off.

1) As examples of texts on set-off by declaration :

Article 127 of the Dutch Code :

“Where a debtor who is entitled to set-off ( compensation) **makes a declaration** to his creditor that his debt be compensated by a claim, both obligations are extinguished up to the amount which they have in common”

Article 388 of the BGB :

“Set-off applied by the declaration made by one party to the other “

2) Example of a text on “ipso jure” set-off

Article 1672 du Code du Quebec:

“Where two persons are reciprocally debtor and creditor of each other, debts for which they are liable are extinguished by compensation, up to the amount of the lesser debt”

### **Declaration by notice**

If set-off; by informal declaration, is adopted for the UNIDROIT Principles it must be decided for the way to make the declaration. The declaration may be exercised by notice (article 1-9 of Principles).

If later, parties plead in court, the judgment will have only declaratory effect, set-off applied at the date of the declaration by notice, even if the effective date is retroactive at the time where the two obligations confronted each other. The declaration by notice cannot be subjected to a condition. The debtor cannot declare set-off for the future.

An article may provide

**“The declaration of set-off is exercised by notice to the other party**

It is also possible to express in the same article that

**“Set-off must be declared. The declaration will be exercised by notice to the other party”**

An other important question must be now discussed: What will be the effective date of the set-off ?

### III - Retroactivity or non retroactive effect ?

If law was logical, the effective date will depend on the conception of set-off.

Under an automatic or “ ipso jure ” conception of set-off, the set-off should be retroactive to the date of the creation of the set-off. ( when the two obligations confronted each other) Invoking in court (but not declaring ) the set-off, the debtor merely takes advantage of a pre-existing legal occurrence.

The requirement for an informal voluntary declaration might lead one to believe that the set-off would take effect as the date of this informal declaration.

So if the retroactivity is justified by the “ipso jure” conception, the substantive requirements for set-off must exist at the date where the two obligations confronted each other, and at that time the two obligations are extinguished. An if there is not a legal retroactive effect, the legal conditions for set-off had to be gathered at the date of the declaration, and at that time the two obligations are discharged.

Of course there are practical consequences: In the “ipso jure” conception interests will not accrue from the moment when the two claims could have

been set-off against each other, in the pure conception of set-off by declaration, the defence of limitation may be opposed even if the limitation occurred after the two obligations confronted each other.

But law is not always logical . Almost all the civil law systems, (the only exceptions are the Nordic countries) regard the obligations as discharged at the moment when, (the conditions for the set-off, being gathered), the second obligation met the first obligation. The rule is justified or by the application of the “ipso jure” set-off or by giving a retroactive effect to the declaration of set-off

So, it is possible to imagine a lag in time between the creation of a set-off and the effective date. The set-off might be given retroactive effect. Many systems where a declaration is required to assert the set-off, had decided that set-off has a retroactive effect to the date where the two obligations coexist.

Thus, the effective date of the set-off could pose a problem.

As almost all systems adopt retroactive effect it seems perhaps easier to adopt the retroactive effect for the UNIDROIT Principles, even if it is not quite coherent with a set-off by declaration. Perhaps we must wonder what date is the easier to ascertain.

We must point out that Zimmermann draft proposed what is called a “ex nunc effect”. Set-off operate by the declaration by notice, but there is no retroactive effect. The date of the declaration is the effective date of the set off. Set-off has merely prospective effect. The conditions for the set-off must exist before the declaration

“Set-off discharges the obligations, as far as there are coextensive, as from the time of notice”.

Are coextensive and “ coexisting” similar ?

The proposition of the Lando Commission is a rather unusual rule.

So we have to appreciate what date will be the best choice for international business transactions.

An article on the effective date of set-off could be :

1) With retroactive effect :

**“The effect of the set-off is to extinguish the two obligations at the date where they coexist”**

**or**

**“The two obligations are extinguished at the date where they both exist**

**or**

**“Set-off is retroactive to the time that the right to set-off has arisen”**

**or**

**Set-off discharges the two debts ( obligations) from the time they first confronted each other**

2) Without retroactive effect :

**The effect of the set-off is to extinguish the two obligations at the date of the declaration by notice**

**or**

**The two obligations are extinguished as from the date of the declaration by notice**

**or**

**Set-off discharges the two debts ( obligations) as from the date of the declaration by notice.**

#### IV - The Conditions of set-off

Rereading the minutes of our meeting in Rome in March 1998, it seems to me that questions relating to the range of situations in which set-off may be applied raised the most discussions, particularly among the representatives from the Common Law systems.

The situations in which set-offs are available will be determined by the strictness of the prerequisites imposed. If there are strict conditions, the range for set-off will be reduced.

Is it necessary to limit set-off, as certain English authors have suggested, to debts deriving from the same contract ? This would certainly narrow the number of situations in which a set-off could be asserted.

The idea that set-off can only applied to debts arising from the same contract derives from the view of set-off as a procedural device. The judges must consider only the arguments raised by the parties and may decide only the matters in dispute between them. It is logical that, where the court asserts the set-off, it may only do so in the course of settling the dispute.

The existence of a link between the debts is also admitted in Civil Law countries which recognize the set-off of related debts (“dettes connexes”), but only when the set-off is pleaded in court ( compensation judiciaire) and when the conditions for an “ipso jure” set-off do not exist.

All legal systems require some legal conditions for applying set-off. The conditions must exist at the effective date of the set-off.

Mutuality  
Fongibility  
Liquidity  
Enforceability

a. Reciprocity- Mutuality of the Debts

Reciprocity is an essential requirement. It is in the nature of set-off. All systems require this reciprocity. The claims must exist between the same party on the same capacity.

This requirement nevertheless raises some problems about the identity of the creditor who has to be also debtor and in the same quality. A set-off cannot be asserted between a debt due by a party in his own right and one due to him as trustee or administrator;

Difficulties also may arise when one of the debtors is a legal entity, for example a corporation or partnership. As a rule, legal entities are independent of their members, so it should not be permitted to set-off, members' personal debts with debts owed to the legal entity. It should be absolutely necessary that the creditor will be debtor of the party who claims the set-off. A parent corporation should not be allowed to claim a set-off for the debt that his creditor owes to subsidiaries, even if the parent corporation guaranteed the debts. The difference between the legal identities prohibit the set-off: The two debts are not reciprocal.

Another difficulty arises from the transfer of rights, where no reciprocal relation existed at the time of the creation of the second debt. There are different solutions to this problem in the different legal systems.

Imagine that a creditor demands payment from one of his debtors and the debtor (who was not, originally, also a creditor) asserts a set-off based upon a debt he has purchased afterward, through a transfer. This will be valid for set-off, only if the transfer of the original debt is enforceable against the creditor by the debtor.

Some systems of law ( as in French law) require that certain formal prerequisites be respected : notice of the transfer must be made to the debtor whose debt is transferred ( débiteur cédé). But, according to the automatic effect of the set-off, there is no need for this debtor to approve or acknowledge . He must merely receive notice. A different result is found in some systems of law (as in German law) where the declaration of set-off is a voluntary act which gives rise to the set-off. There, in the case of a transfer of the right, the approval of the three parties, the assignor, the assignee and the debtor whose debt has been transferred, is necessary.

But we can wonder if this problem about assignment of right would not be better discussed in the chapter on assignment and not in the chapter on set-off.

For the UNIDROIT Principles, **mutuality will be a condition of set-off**

b. Fungibility of the Debts ( Obligations of the same kind).

Two things are fungible if they can each replace each other without harm. A requirement that the two obligations to be subject to the set-off be “fungible” seems desirable. Since a goal of the set-off is to simplify the making of two separate payments, the result of the set-off should be the same as if two payments had been made. The fungibility of the debts seems to incorporate an essential element of set-off, if set-off is a way of extinction of obligations.

Would it be preferable that set-off could be asserted only in situations involving monetary debts ? It is almost always the case in practice. It seems that in common law countries, set-off is limited to monetary debts.

If one limits the applicability of set-off to monetary debts the only difficulty presented is the problem of **foreign currency** debts. Most legal systems are reluctant to apply set-off when one of the debts is stated in a non-convertible currency, but there is even a reluctance to apply set-off when the currencies are convertible. Obviously, when dealing with international commercial transactions, debts must be paid in different places and in different currencies.

Notwithstanding the different and rather reluctant approaches, set-off, in international business transactions, seems desirable and should not pose great difficulty if the currencies are convertible.

Set-off would be available if it does not prejudice to the other party, or if it is not prohibited by agreement.

Two approaches may be envisaged :

On the one hand, as a rule, set off is not allowed, if currencies are different, except where otherwise agreed.

From an other hand, set-off is allowed except where in an agreement it is provided that payment will be only in a specified currency

We can point out article 8 (6) of the EU-Regulation on the Introduction of the Euro, come in force on the 1 January 1999. This article states that any conversion has to be effected “at the conversion rates”, which is “ the irrevocably fixed

conversion rate adopted for the currency of each participating member State by the Council according to article 123 of the EC Treaty”.

Of course this text concern only European countries, having all convertible currency.

Zimmermann, last draft, accept the principle of set-off of two debts in different currencies, but the parties may accept this possibility in an agreement

“ Where parties owe each other money in different currencies, each of them may set-off his claim against the other party’s claim, if he is allowed to pay in the same currency as that of the other party’s obligation or in the currency of the place where the other party’s payment is due.

He proposes an alternative, which seems clearer:

“ Where parties owe each other money in different currencies, each of them may set-off his claim against the other party’s claim, unless the parties have agreed that the party declaring set-off shall pay only in a specified currency”

Apart from the monetary debts, one can also imagine a system where the right to set-off is more expansive, including obligations to deliver commodities where the price is fixed by a market price list or securities.

### c. Liquidity of the Debts ?

The notion of liquidity must be precised.,

In a first aspect, a debt is “liquid” when it is certain, and its amount determined.

In a second aspect a debt is “liquid” when it is not contested. We must had in mind this difference, even if set- off may perhaps be opposed upon a contested debt.

It seems at first glance that, if the requirement of liquidity is not required , there is a danger to a defendant to delay proceeding, claiming set-off, for an obligation which needs to be proved. If one can insure that there can be no dispute as to the existence or amount of the debt, the method for implementing set-off will be greatly simplified. The judge will only verify that the two obligations are determined, ascertained. But the requirement of the liquidity of the two debts will perhaps reduce the possibilities to assert a set-off.

We find different solutions in the different systems of law. In the “ipso jure” conception, liquidity of the two debts is a substantive requirement. In other legal systems, the liquidity of the two debts is not always prescribed, its depends on the

conception, broad or reduced of the set-off and of the power granted to the judge . In these systems, one may seek the intervention of a court to appraise the existence and the value of the two debts.

Swiss law for example expressly admits in article 120 of the Code des Obligations : “The debtor may oppose set-off even if its right ( créance) is contested” . German law does not impose as a requirement for set-off, the liquidity of the cross claim The judge will appreciate if set-off must be accepted. Dutch law had adopted a kind of compromise position, “The judge may grant judgment in favour of the plaintiff notwithstanding the fact that the defendant invokes set-off, if the validity of this defence cannot easily be ascertained ant the action would otherwise succeed”. Italian law provide for a rather similar rule. Sometimes the cross claim does not need to be ascertained if the two obligations arise from the same relationship.

But of course if set-off is available when the two obligations or one of the obligation can be unascertained we are flowing from substantive law to procedural set-off . It will be in the province of the judge to allow or not, the benefit of the set-off.

If the cross claim can be unliquid we are in a judicial set- off and perhaps some procedural difficulties would arise. In some circumstances it will be possible to hesitate between a procedural action for set-off, (if it is a special kind of judicial proceeding) or an ordinary judicial proceedings. The difference being in the effective date. For example if, as it is possible in the United States, by the provision of § 2-717 of the UCC, the buyer of defective goods is allowed to subtract the damages, the proceeding will be a judicial set-off or an ordinary proceeding ?

If requirement of liquidity is adopted for the principal claim or for the two obligations, the amount of the debts must also be determined. The debt must be ascertained in its existence and in its value.

To accept that the cross claim could be unascertained or to impose the liquidity of the two obligations depend essentially on the power granted to the judge

The Lando Commission adopts a third ( procedural) approach The defendant cannot assert an unascertained claim “unless the set-off will not prejudice the interest of the other party” and it is presumed that there is no prejudice, if the two obligations arise form the same relationship.

Of course, it will not be always easy to determine “the same relationship”, and what means exactly the prejudice of the other party ?

So perhaps it will be simpler to choose between the two main solutions adopted in the different systems.

1) The two obligations must be liquid.

This requirement limits, the possibilities to oppose a set-off, and the power of the judge. But things are clear.

2) The cross claim does not need to be ascertained.

It will be in the province of the judge, in each case to appreciate if set-off may or not be allowed. The judge, among other circumstances, could take into consideration that the two obligations arise from the same relationship.

It will be also possible to provide only an article, more general, admitting the possibility, by agreement to a judicial set-off, if the conditions for the set-off are not fulfilled.

It can be proposed :

1) If liquidity is required for the two debts :

**The two obligations to be set off must be liquid**

2) If liquidity is required only for the cross claim:

**The cross claim needs not to be liquid**

**or**

**A debtor may not set off a claim which is unascertained as to its existence or to its amount**

**or**

**The cross claim can be unascertained or contested.**

**3) When a requirement for set-off is not fulfilled, the parties may agreed for a judicial set-off.**

Lando Commission :

“A debtor may not set off a claim which is unascertained as to its existence or to its amount unless the set-off will not prejudice the interests of the other party. It is presumed that the other party’s interests will not be prejudiced, where the claims of both parties arise from the same legal relationship.

d). Enforceability – (Exigibility of the debts - Debt become due )

There is a problem of terminology. “Enforceability”, “exigibility” “debts become due” : Are these three terms similar ? “Exigibilité” is the word used in some civil law countries ( France, Italie, Espagne, Suisse, Quebec) it means that the creditor has the right to demand present payment, the debtor is not all allowed to raise a

defence. This is contrasted with a debt which becomes due on a specific date in the future, or a debt arising from a “natural obligation”. Perhaps enforceability is more strict than “becoming due”. Where a debt becomes due is it always enforceable? We must choose the vocabulary.

The debtor can refuse to pay a debt which is not yet enforceable, he is not obliged to pay before the date agreed upon for payment. In commercial transactions, it seems that only delays which have been granted are likely to render a debt not payable. In another way, an illegal debt, such as a gambling debt, might also not be enforceable.

Some legal systems require that a debt be enforceable, before it can be the basis for a claim and also before it can be asserted as a set-off. The requirement of enforceability of the two debts depends on the conception of set-off. In England, according to the judicial conception, the principal claim must be enforceable, if the plaintiff has no enforceable claim, the other party cannot oppose set-off. The same requirement exists in the “ipso jure” conception, where actually there is neither principal claim nor cross claim.

In some other legal systems ( German law, Dutch law), the first ( principal ) claim has not to be enforceable. But as set-off leads to a payment, the cross claim must be enforceable. The debtor is not allowed to oppose a claim which is not yet due. A party may oppose the set-off even if the debt owed by him is not enforceable. It is his choice to accept to pay before the contractual date for the payment. In a conception of voluntary set-off, the debtor may assert the declaration of set-off even if his debt is not yet enforceable. He may also not decide to pay by set-off. It depends on the choice of the debtor, he may refuse the legal protection granted to him.

The possibility for a debtor to claim set-off, opposing a time barred debt (dette prescrite) may rise also problem.

If the limitation does not extinguish the right, but the claim arising from that right, it seems possible, **in defence** ( par voie d’exception) to oppose the expired debt, like a natural obligation. If the debtor pays the time barred debt, his payment is regular and he will not be able to plead to have the money back. Some systems have expressly considered the expired debt. Article 131 of the Dutch Code provides: “The right to set-off is not terminated by the limitation of the right of action” Also the Swiss Code ( article 120) : “ Set-off of a time barred obligation may be opposed if the obligation was not extinguished by limitation at the time where the two debts confronted each other”

The requirement of a debt enforceable raises also the problem of the possibility to assert set-off when a procedure of insolvency has begun. Most legal systems apply special rules for insolvency set-off. Generally speaking, insolvency does not prohibit set-off, but set-off will be under the control of the judge. One of the main rules in insolvency proceedings is the equality between creditors. The assets of the insolvent debtor are no longer available for individual creditors. But from one hand if,

without control, a debtor may oppose its own obligation against the insolvent, he will be paid when the other creditors will receive only dividends. And on the other hand, why the debtor ( if he cannot opposed set-off) will be condemned to pay the full amount of his liability and will receive ( in the better case), only a proportional share from the insolvent asset ?

The problem arises when the conditions for set-off are gathered before the beginning of the insolvency procedure. In some systems ( as in France) if one of the debtor his insolvent, the set-off will be a procedural set off , and the judge has to verify that the two obligations arise from the same relationship ( dettes connexes).

But is it necessary to adopt an article on insolvency-set-off ? Insolvency is a specific procedure in domestic law, UNIDROIT Principles, dealing with set-off, are not directly concerned with these special rules.

Concerning the requirement of enforceability , there could be an alternative :

**1) The two debts had to be enforceable.**

**2) A debtor is entitled to set-off if he has both the right to pay its own obligation and the right to enforce payment of the other party's obligation**

Zimmermann draft :

A party may set-off his claim against the other party's claim if

- a) he is entitled to effect his own performance and
- b) the other party's performance is due

## V - Plurality of debts

An other practical question may also be dealt in the Principles : Where **several debts** may be set-off it must be decided which of them will be set-off. It depends on the conception of set-off adopted.

In a "ipso jure" set-off, the debts are extinguished without the intent of the parties and the law will decide which debts will be first set-off. The rules provided by article 6.1.12 of the Principles will be followed.

In a set-off by declaration, the debtor who opposes the set-off, has to identify precisely the debt he wants be set-off. If he does not make this identification, or the notice will be invalid being not enough precise, or the intention of the party giving notice may be found, or the rules of the article 6.1.12 will apply.

If the party giving notice had to perform various debts, the rules of article 6.1.12 will applied, but it is also possible to admit that the party receiving the

notice may, in a reasonable time, object to the identification of the debts made by the debtor declaring the set-off by notice

Lando Commission :

(1)“Where a party giving notice of set-off has two or more claims against the other party, he has to identify to which of his claims the notice of set-off relates.

(2) Where the party giving notice of set-off has to perform two or more obligations towards the other party, the rules in article 7:109 apply with appropriate modification”

## VI - Exclusion of set-off

In all systems of law, some debts are excluded from set-off. First, according to the general principle of freedom of contract, parties may, by agreement exclude set-off. There are also certain debts which, by their object or their nature, seem to be excluded from set off, more often for humanitarian reasons. It is the case for debts non capable of attachment ( créance insaisissable). It will be unfair to deprive one person of a minimum level of subsistence. It depends from each legal system to determine what are the debts non capable of attachment

Also set-off may not be admitted if the debt opposed arise from an illegal situation. In this case the creditor is allowed to receive a concrete payment. There are, in domestic laws, several and different debts excluded, but it seems that exclusion of debts non capable of attachment and arising from a wilful act (even if more often the different systems express these ideas in different ways ) is recognized or may be accepted in all systems.

We can refer to the Lando Commission. Last Zimmermann draft proposes:

“Set-off cannot be effected

- a) where it is excluded by agreement,
- b) against a claim to the extent that it is not capable of attachment and
- c) against a claim arising from a wilful delict.

### Summing-up :

If the working group of Unidroit decides to recommend the promulgation of rules relating to set-off, the main following questions must be discussed:

1) Is set-off to be considered of procedural or substantive law ?

2) Does the party who intent to oppose set-off has to inform the other party of his intent and to make a declaration of the set-off ?

- an informal déclaration ?
- a declaration in court ?

3) What will be the effective date of the set-off ?

-retroactive effect, (from the time where the two debts are confronted each other)

- date of the declaration,
- date of the judgement)

4) What conditions must be imposed for set-off ,

- mutuality,
- fongibility ( debts of the same kind)
- liquidity
- enforceability ( exigibilité)

5) Rules when there are several debts

6) Debts excluded from set-off