

UNIDROIT 2002
Study L – Doc. 78
(English only)

UNIDROIT

International Institute for the Unification of Private Law
=====

WORKING GROUP FOR THE PREPARATION OF
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

WAIVER AND RELATED ISSUES

(Position paper prepared by Justice P. Finn)

Rome, May 2002

The issue addressed in this paper can be stated in the following way:

Do the Principles as presently formulated deal adequately, or with sufficient particularity, with the circumstances in which contractual rights and obligations may be modified, suspended, lost or renounced?

I differentiate “adequacy” and “sufficient particularity” for this reason. General gap-filling provisions in the *Principles* (and especially Art 1.7: “good faith and fair dealing”) may be able to cope adequately with those circumstances for which no express provision has been made in the *Principles* in which it is alleged that rights have been modified etc. Nonetheless it may be considered more appropriate for the *Principles* to provide more explicitly than is presently the case for the circumstances in which, and/or the means by which, modification, etc will have, or will be taken as having, occurred so reducing reliance on the gap-filling provisions: cf Schlechtriem, *Good Faith in German Law and in International Uniform Laws*, 15-16, Centro di studi e ricerche di diritto comparato e straniero, Roma 1997.

The *Principles*, at the moment, deal in general terms only with modification or termination: Arts 1.3, 2.18, 3.2. Otherwise in specific provisions, they deal with instances where rights will be suspended (eg Arts 7.1.4, 7.1.5), extinguished (eg Art 3.12) or be unable to be relied upon (eg Art 2.18). Almost all such specific provisions are said to be direct or indirect applications of the principle of good faith and fair dealing: Art 1.7 Comment 1.

The question for the Working Group is whether further express provisions should be added to the *Principles* dealing with the above subject matter and if so what form they should take.

Background

It has not been proposed that the Working Group undertake a systematic reappraisal of the *Principles*. For this reason the starting point I would suggest for the purposes of discussion is this:

Absent clear reason for change, any proposals should be such as will maintain the coherence and the relative simplicity of the Principles as they stand.

For present purposes the *Principles* espouse one significant policy. Article 1.3 provides that a contract “can only be modified or terminated in accordance with its terms or by agreement or as otherwise provided in these Principles”. Comment 2 to this Article reinforces this. It states that modification or termination without agreement “are ... the exception and can ... be admitted *only* when in conformity with the terms of the contract or when *expressly* provided for in the Principles”: emphasis added. The principal expressly provided exceptions relate to court reformation of a contract in cases of gross disparity (Art 3.10) and of hardship (Art 6.2.3). Notwithstanding Article 1.7, Article 1.3 as explained would seem to create a relatively inelastic environment in which to argue that a non-consensual contract modification has occurred (eg by way of irreversible preclusion) in situations for which no express provision has been made.

I would also emphasise at the outset that, save in one respect, the *Principles* are designed to facilitate consensual modification. Article 3.2 provides that a contract will be modified “by the *mere* agreement of the parties, *without any further requirement*”: emphasis added. As Comment 1 to Art 3.2 notes, this provision departs from the traditional rule in common law countries (but cf *Uniform Commercial Code*, Art 2-209(US)) in that it dispenses with the requirement of consideration. The saving I foreshadowed is a consequence of Art 2.18. Unlike Art 2:106 of the PECL, Art 2.18 of the *Principles* gives full effect to a contractual provision requiring agreed modifications to be in writing. Significantly, though, the Article does provide by way of qualification that:

A party may be precluded by its conduct from asserting such a clause to the extent that the other party has acted in reliance on that conduct.

This, I would note, is one of the few express preclusionary provisions in the *Principles*.

One additional introductory comment should also be made. It is clear that some specific provisions at least will have to be added to the *Principles* in light of the work the Group has done so far. An example of this is a provision dealing with renunciation of prescription: cf *French Civil Code* Book 3, Art 2220; *Civil Code of Quebec* Art 2883.

Modification, Suspension, Loss or Renunciation of Rights

I do not consider it is likely to be profitable to engage in a technical analysis of the various legal doctrines and rules deployed by individual legal systems which allow or compel the modification, etc of contractual rights and obligations, for the purpose of discerning commonalities or some lowest common denominator. In common law countries, for example, those doctrines and rules have, for the most part, applications extending far beyond the regulation of the rights and obligations of contracting parties. In their contractual applications they can vary widely in their levels of acceptance, scope and incidents – and for reasons which are by no means principled or unobjectionable: see eg the discussion of US law in Farnsworth, *Changing Your Mind*, Part II. The laws of estoppel and of waiver are of this character.

The course I consider the more appropriate and would propose to the Working Group is as follows:

Having regard (a) to the primary policy of modification by agreement expressed in Arts 1.2 and 3.2 and (b) to the gap-filling provisions of Arts 1.6 (2) and 1.7, we consider in what circumstances the *Principles* should make additional express provision for the non-consensual modification, suspension, loss or renunciation of a right or obligation:

- (i) as a consequence of one party's unilateral action ("Unilateral Action"); and
- (ii) where one party, having by its conduct created or knowingly encouraged an assumption upon which the other has acted in reliance, seeks then to depart from that assumption ("Inconsistent Behaviour").

The reason I propose we direct our attention to what I have described as "unilateral action" and "inconsistent behaviour" is that, across legal systems, each can be a well recognised cause of the conditions sufficient to justify the conclusion that a right or obligation has been non-consensually modified, etc.

Before considering each in turn, I should also acknowledge that a relevant consideration in a decision whether a right or a performance should be regarded as having been non-consensually modified, etc and if so irreversibly, may be whether the time for the acquisition and/or exercise of the right or for rendering the performance has arrived. Under §2-209(5) of the *Uniform Commercial Code*, for example, a party

who has waived an executory portion of a contract may, subject to certain conditions, retract the waiver and insist on strict performance of any term waived: see also *Restatement of Contracts Second*, §84(2); Farnsworth, *Contracts*, §8.5 (3rd Ed). Distinctly, under Art 2220 of the *French Civil Code*, prescription cannot be renounced in advance, but an acquired prescription may be renounced.

I should also make a further introductory comment on the choice between including further express provisions or continuing to rely upon Articles 1.6(2) and 1.7 as gap-fillers. If the latter course is preferred consequential questions will arise. They relate (a) to how far comment on particularly Article 1.7 should go in indicating that it can apply directly so as to contrive a modification etc of contractual rights and obligations: cf PECL Art 1:201, Comment C, “Inconsistent Behaviour”; and (b) whether the comment to Article 1.3 should state that that Article is itself subject to Article 1.7: cf PECL which has no direct equivalent to Article 1.3.

Finally I have attempted insofar as possible in this paper to avoid use of the terms “estoppel” and “waiver” in the following discussion. These terms are likely to have significantly different meanings across legal systems. They clearly do, for example, as between common law countries.

A. MODIFICATION, ETC, AS A CONSEQUENCE OF UNILATERAL ACTION

For the purpose of discussion I have assumed that a party to a contract should not by its own action alone be able to add to the obligations, or diminish the rights, of the other party without an express provision in the contract allowing it to do so. Nothing in what follows is directed at such cases.

My concern is with the circumstances in which the *Principles* should expressly provide that a party, by or as a result of its own action alone:

- (a) has renounced or relinquished (temporarily or permanently) a right of its own; or
- (b) has relieved the other party (temporarily or permanently) of some part or some requirement of its performance under the contract.

There clearly are two classes of case where the *Principles* now expressly deem a party by its unilateral action to have renounced (temporarily or permanently) a right it

possesses. These classes embody the concept of *election* and are instances in which a choice between inconsistent rights recognised by the *Principles* is required or permitted to be made and, on the making (or deemed making) of which, one right is either lost or suspended.

(i) Election

The type of case envisaged by the *Principles* where the choice between inconsistent rights is required to be made and, when made, gives rise to the *permanent loss* of one right is that where rights to avoid for fraud, etc given by Article 3 (see Arts 3.5, 3.8, 3.9 and 3.10) are lost by confirmation of the contract: see Art 3.12. Confirmation does not necessarily depend on an actual intention to confirm (although in fact such an intention is commonly present). It can result from continued performance of the contract without reserving the right to avoid: see Comment to Art 3.12.

The type of case envisaged by the *Principles* where a choice is permitted to be made which results in the *temporary suspension* of rights is that where, a non-performance having occurred, the aggrieved party allows an additional period for performance. In such a case a suspension of rights (being those inconsistent with the forbearance shown) occurs during the additional period given: Art 7.1.5.

There is a distinct class of case in which it might be said an issue of election arises but for which no express provision is made in the *Principles*. This relates to loss of the right to terminate for breach because the aggrieved party has so conducted itself as to confirm the contract notwithstanding its right to terminate. Common law systems recognise this situation as one of election in the same way that a right to avoid for, or to confirm a contract notwithstanding, fraud etc is one of election: see *The Law of Contract*, 7.29, 7.30 (1999, Butterworths); Farnsworth, *Contracts*, §8.19; Cheshire & Fifoot's *Law of Contract* (Aust Ed), §21.18 – 21.20; and see Art 3.12 of the *Principles*.

The need or otherwise to include in the termination provisions an Article paralleling Art 3.12 may well have been considered and rejected by the first Working Group. If no such decision was then taken I raise for consideration the question:

Should the Principles provide expressly in Art 7.3 for the loss of the right to terminate for breach if the innocent party expressly or impliedly affirms the contract after the time for giving notice to terminate has begun to run?

Such a provision would reflect in the termination provisions what is provided in Art 3.12 in relation to the avoidance provisions. The PECL, I would note, has no such provision, though it does have an equivalent to Art 3.12: see PECL Art 4: 114.

Possible reasons for not including an express “election” provision are (a) that the right to terminate is lost in any event unless the aggrieved party gives notice of termination within a reasonable time after it became or ought to have become aware of the relevant breach: Art 7.3.2(2); (b) that the aggrieved party can give additional time for performance: Art 7.1.5; and (c) a non-performing party can, subject to conditions, cure a non-performance: Art 7.1.4. It might be thought that together these provisions deal sufficiently with protecting the interests of both parties where a terminating breach has occurred and that any residual cases that might arise concerning exercise of the right to terminate are best left to Art 1.7.

It is clear that the *Principles* contemplate that Art 1.7 has a role in relation to the exercise of the right to terminate. Comment 2 to Art 7.3.2 (notice of termination), for example, provides:

“This article does not deal with the situation where the non-performing party asks the aggrieved party whether it will accept late performance. Nor does it deal with the situation where the aggrieved party learns from another source that the non-performing party intends nevertheless to perform the contract. In such cases good faith (Art 1.7) may require that the aggrieved party inform the other party if it does not wish to accept the late performance. If it does not do so, it may be held liable in damages.”

(ii) Limitation Periods

A distinct type of case which may not strictly be regarded as involving an election but which does provide a choice to a party, relates to limitation periods.

Our draft provisions on limitation periods entitle an obligor to assert the expiry of the limitation period as a defence in any legal proceeding: Draft Art 9; they entitle the parties within limits to modify the periods of limitation: Draft Art 3; and the obligor can by acknowledgment begin a new general limitation period provided the acknowledgment is made *before* the expiration of the limitation period: Draft Art 4.

The questions left outstanding in relation to limitations which are relevant to the present discussion would seem to be the following:

(i) *Should the Principles expressly permit a party to renounce its Draft Article 9 right to invoke the limitation period after that right has accrued and irrespective of whether the right results from the expiration (a) of the general limitation period, or (b) of the maximum limitation period?*

(ii) *Should the Principles go further and oblige that party to make an election whether or not it renounces or insists upon its right to assert the limitation period?*

(iii) *Does or should the renunciation of an accrued right have the effect of creating a new general limitation period in respect of the right to which the expired limitation period related?*

Save that I consider Q(ii) above to be inconsistent with the general approach taken in the *Principles*, I do not proffer views on the above. The rapporteur for limitation periods can, I anticipate, provide appropriate guidance on the issue of renunciation. The one comment I would make is this. It may be considered that there is a need to harmonise in some degree the consequences flowing from renunciation, with those prescribed in Draft Article 4 which flow from “acknowledgment”. That Article provides:

“Where the obligor, before the expiration of the limitation period, acknowledges the right of the obligee, a new general limitation period begins on the day after the day of the acknowledgement. The maximum limitation period does not begin to run again, but may be exceeded by the beginning of a new general limitation period under Art 2(1).”

The PECL provisions on prescription do not contain an express provision dealing with renunciation. The PECL equivalent to the *Principles*’ acknowledgment provision is, however, not limited to acknowledgment “before the expiration of the limitation period” (cf our Draft Art 4). Article 17:112 of the PECL provides:

“Article 17:112: Renewal of Prescription

(1) If the debtor acknowledges the claim, vis-à-vis the creditor, by part payment, payment of interest, giving of security, or in any other manner, prescription begins to run again. The period of prescription is the general period of prescription. In cases of prescription under Art 17:103 (ie for a claim established by

judgment) this does not, however, operate to the prejudice of the ten-year-period.

(2) The ten year period of prescription laid down in Art. 17:103 begins to run again with each reasonable attempt of execution undertaken by the creditor.”

(iii) The Unilateral Renunciation or “Waiver” of a Right or of a Requirement of Performance

(a) Independent Rights

There is a number of rights that may be possessed by a party to a contract (a) which are recognised or conferred by the *Principles* on that party for its benefit without the agreement of the other party (although they may in fact be the subject of agreement) but (b) which that party is not obliged to exercise. I refer, for example, to rights to avoid, to terminate, to raise the limitation period, to raise a set-off, etc. I will refer to these somewhat inaccurately as “independent rights” in that they do not depend for their existence on agreement although they may be restated, modified or excluded by the contract in a particular case. Some number of these, as I have already noted, give rise directly to an election between inconsistent rights with the consequence that one right will be lost (or renounced) by the election made. Some other of these rights, while providing a choice to a party as to whether or not they will be exercised – eg raising the limitation period, or a set-off – may not be considered as raising an election between inconsistent rights as such.

As a practical matter the only two rights likely to be of real significance in the latter category for present purposes would seem to be the rights to raise the limitation period and to raise a set-off. The former of these has already been considered. For my own part I see no policy objection to a right to raise a set off being renounced after a claim has been made.

The question of waiver of set-off was raised at our Rome meeting. For this reason for the purposes of discussion I would propose that:

A party, having the right to raise a set-off, may by notice to the other party renounce that right in relation to the claim or claims of the other party that are specified in the notice.

I would suggest, though, that this is not a subject of such importance as to warrant an express provision in the *Principles*.

(b) Rights and Performance that Have Been Agreed

Different considerations apply when considering whether the *Principles* should expressly permit or condone the unilateral modification, etc of a right or a performance that has itself been agreed. Consistent with the primary policy of modification by agreement, I would propose that compelling reasons should be given before unilateral modification should be permitted. I advance this proposal recognising that such unilateral action in a particular case might be demonstrably beneficial to the other party as where, for example, an interest liability is unilaterally reduced.

There obviously are cases where a party should be precluded from setting up the lack of an agreement to modify because the conditions necessary to found an estoppel have been made out. Such preclusion is considered in the following section. The concern here is with the effect to be attributed to the actions of one party alone without regard to the other's reliance or change of position. The practically significant cases to be borne in mind are likely to be those in which one party unilaterally purports (a) to renounce or to suspend a right of its own or (b) to forego or to suspend a performance requirement of the other.

For the purposes of discussion I would make the following suggestion. Notwithstanding the possible inconvenience that may arise by having to prove an actual agreement to modify etc a contract: cf Farnsworth, *Contracts*, §8.5; that inconvenience ought be tolerated both because of the simplicity of the primary policy of modification by agreement and because it would be likely that provisions of some complexity would be required setting limits to when rights and performance obligations were able to be modified, etc by unilateral action. The need for such limits would arise primarily because of the possible impact a purported modification etc might have on the substance of the contract itself and on the other parties expectations of it.

For the purposes of discussion I would propose the following:

No express provision be added to the Principles that would, in the absence of agreement, permit unilateral modification of any of the terms of the contract.

Save in cases of election and of reliance/inconsistent behaviour (see below), the policy of modification by agreement should be insisted upon. I would suggest that in many if not most instances in commercial dealings, one party's action "waiving" a right or performance requirement will itself be the product of a request for forbearance by the other. In such circumstances an agreement can be inferred readily enough.

A contrary view to what I have proposed may commend itself to the Working Group. For this reason I would draw to the Group's notice the provisions of s 63 of the *Indian Contract Act*, 1872. It states:

"Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit."

B. RELIANCE/INCONSISTENT BEHAVIOUR

The type of case to be considered in the following discussion is that in which one party has acted upon an assumption that was induced or perpetuated by the other party who later seeks to act inconsistently with that assumption. In common law systems this situation characteristically was, and is, dealt with by the doctrine of estoppel.

Simply to illustrate that doctrine's scope and its basic features I refer for convenience to the manner in which it has been formulated in Australian law (*Thompson v Palmer* (1933) 49 CLR 507 at 547):

"The object of estoppel in pais is to prevent an unjust departure by one person from an assumption adopted by another as the basis of some act or omission which, unless the assumption be adhered to, would operate to that other's detriment. Whether a departure by a party from the assumption should be considered unjust and inadmissible depends on the part taken by him in occasioning its adoption by the other party. He may be required to abide by the assumption because it formed the conventional basis upon which the parties entered into contractual or other mutual relations, such as bailment; or because he has exercised against the other party rights which would exist only if the assumption

were correct; or because knowing the mistake the other laboured under, he refrained from correcting him when it was his duty to do so; or because his imprudence, where care was required of him, was a proximate cause of the other party's adopting and acting upon the faith of the assumption; or because he directly made representations upon which the other party founded the assumption. But, in each case, he is not bound to adhere to the assumption unless, as a result of adopting it as the basis of action or inaction, the other party will have placed himself in a position of material disadvantage if departure from the assumption be permitted."

The ideas embodied in this are well known across legal systems even though some may not resort to the language of "estoppel" to give effect to them. The principle of good faith and fair dealing commonly is used to this end as, for example, in German Law through §242 BGB: Cohn, *Manual of German Law*, Vol 1, §194(c).

The *Principles* do not contain a general provision incorporating what, for convenience, I will call estoppel. Rather they contain a number of particular provisions (i) that embody distinct instances in which one party is not permitted to depart from an assumption upon which the other has acted or (ii) that partially incorporate ideas drawn from estoppel. As to the former I would note the qualification in Art 2.4(2)(b) to the power to revoke an offer making an offer irrevocable if it was reasonable for the offeree to rely on it as being irrevocable and the offeree has acted in reliance on it; and the preclusion from asserting a written modification clause in Art 2.18. Illustrative of partial incorporation are Art 2.15 (negotiations in bad faith), Art 2.20 (surprising terms) and Art 3.5 (relevant mistake). It should be emphasised that Comment 1 to Art 1.7 states that such examples are direct or indirect applications of the principle of good faith and fair dealing.

The PECL follows the same course as the *Principles* in their present form in having no general estoppel type provision, but with one significant difference. In contrast with the *Principles*, the PECL has sought to give more explicit indications of the substantive content of the principle of good faith and fair dealing.

Comment C to Art 1:201 of the PECL is in the following terms (omitting the illustration):

“C. Inconsistent Behaviour

A particular application of the principle of good faith and fair dealing is to prevent a party, on whose statement or conduct the other party has reasonably acted in reliance, from adopting an inconsistent position. This translates directly into a number of provisions of the Principles, eg Article 2:202(3), which provides that a revocation of an offer is ineffective if it was reasonable for the offeree to rely on the offer as being irrevocable, and the offeree has acted in reliance of the offer, and Articles 2:105(3) and 2:106(2), under which a party by its statement or conduct may be precluded from asserting a merger clause or a no-oral-modification clause to the extent that the other party has reasonably relied on them. See also Article 3:201(3), which lays down that an apparent authority of an agent that has been established by a principal’s statements or conduct will bind the principal to the acts of the agent, and compare Article 5:101(3), which provides that if a common intention of the parties as to the interpretation of a contract cannot be established, the contract is to be understood according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

The rule is, however, broader than any of these specific provisions. It is a general principle that a person should not be allowed to set up the invalidity of an act or another reason for its not being binding upon him when he has induced another person to alter his position on the faith of the act.”

I do not anticipate that the Working Group would find particular difficulty in accepting the proposition contained in the final paragraph of the above quotation subject, perhaps, to the insertion of the word “reasonably” before “to alter his position on the faith of the act”. That proposition really states in short form the more extended description of estoppel I gave above.

Given the way in which the *Principles* and the PECL now respectively deal with what the PECL calls “inconsistent behaviour”, the Working Group has a number of choices open to it in further addressing this matter. I would describe these as follows:

1. *Leave the Principles as they stand without further amendment to the text or the comments, relying upon Arts 1.6(2) and 1.7 to deal with cases of inconsistent behaviour beyond those already provided for specifically.*

2. *Leave the Principles as they stand but (a) add to the Comment to Art 1.7 so as to make explicit what is now implicit, ie that the principle of good faith and fair dealing can be breached by one party resiling from an assumption on which it has induced the other reasonably to act to its detriment should the former be permitted to resile; and (b) add to Comment 2 to Art 1.3 to emphasise that Art 1.3 is subject to Art 1.7.*

3. *Formulate a further mandatory rule (necessarily a derivative of Art 1.7) that deals explicitly with inconsistent behaviour in general terms.*

4. *Formulate such further specific Articles dealing with instances of inconsistent behaviour as are considered to be appropriate and desirable.*

The course I would propose for the purposes of discussion is that contained in 2 above. My reasons for proposing this are as follows.

First, it can properly be said that an “underlying general principle” of the *Principles*: cf Art 1.6(2); is to proscribe one party’s inconsistent conduct where that party has induced the other reasonably to rely upon a particular assumption. That proscription is an emanation of the principle of good faith and fair dealing but it is not described to be so in explicit terms. Given that unprovided for issues within the scope of the *Principles* are to be settled in accordance with the “underlying general principles” of the *Principles*: Art 1.6(2); it seems desirable that where such an underlying principle can be discerned it should be stated explicitly in the Comments at least.

Secondly, the specific provisions of the *Principles* dealing with inconsistent behaviour (eg Art 2.18) are tied directly to Art 1.7 via Comment 1 to Art 1.7. The apparent assumption in this is that such provisions would otherwise be subsumed by Art 1.7 but that they are of sufficient importance in the scheme of the *Principles* to warrant express specific provision. If this be correct, then such purpose as would be served by a new general provision dealing with inconsistent behaviour would seem to

be no more than to provide a specific exemplification of the operation of Art 1.7. The question this raises is whether this exemplification might not more appropriately be indicated in a comment to Art 1.7. As indicated earlier this is the course taken in the PECL.

Thirdly, and I say this with some hesitation in the company of civil lawyers more familiar with such matters, the drafting of a *comprehensive* inconsistent behaviour provision is likely to be a daunting task. Would such a provision be limited to positive conduct (including representations) relied upon by the other party? Or would it extend to silence in circumstances where the other party was thereby misled or would have expected a known mistake to have been corrected? In relation to representations, would the provision extend to future states of affairs and to representations as to intention? Or should it be limited to representations of fact? What would be the legal consequences that could flow from reliance upon the assumption induced etc by the other's conduct and what would be the conditions necessary to give rise to them?

In common law systems, in varying ways, these questions are answered by differentiating between species of estoppel, the differing species having both differing requirements and, importantly, differing remedial consequences. For example, promissory estoppel in the United States and the more expansive principle of equitable estoppel in Australia are essentially causes of action in their own right that can lead to claims for damages and to mandatory orders. In contrast common law estoppel in Anglo-Australian law and equitable estoppel in United States law are simply rules of preclusion preventing the party that induces an assumption from acting so as to falsify that assumption.

My concern is that if the Group was to propose an inconsistent behaviour provision, that provision would itself be likely to be one of considerable complexity if it was to describe the circumstances and consequences of its application. If that complexity was to be avoided by a provision cast in general terms, it is likely that, because of its generality, it would add little if anything to Art 1.7. To illustrate the latter point a general provision could be cast in terms such as:

A party is not permitted to depart unjustly [or unfairly] from an assumption upon which it has induced the other party [reasonably] to rely.

This may capture much of the idea one would wish to convey about inconsistent behaviour. But the burden carried by the operative word “unjustly” might reasonably be thought to differ little from that of the good faith principle.

While not proposing a general inconsistent behaviour provision, I would make the following proposals for discussion purposes:

(i) *The Comment to Art 1.7 be expanded to include both discussion and illustration of inconsistent behaviour as an important application of the Article.*

(ii) *Comment 2 to Art 1.3 be amended so as to indicate that that Article is subject to Art 1.7 and that a modification can occur in consequence of the operation of Art 1.7.*

The first of these proposals, it should be said, marks a departure from the commentary to Art 1.7 as it now stands in that the present Comments say little about the substantive content of good faith and fair dealing (otherwise than by inference from the examples given). If such a departure is thought to be appropriate then it might be asked whether there are not other exemplifications of good faith and fair dealing that should also be mentioned: cf PECL 1:201 Comment.

Summary

1. The general issue to be considered by the Working Group is the following:
Do the Principles as presently formulated deal adequately, or with sufficient particularity, with the circumstances in which contractual rights and obligations may be modified, suspended, lost or renounced?
2. The policy presently espoused by the *Principles* in relation to modification, etc, is contained in Art 1.3:
A contract validly entered into is binding upon the parties. It can only be modified or terminated in accordance with its terms or by agreement or as otherwise provided in these Principles.
3. The *Principles*, more by inference than otherwise, countenance a role for Art 1.6(2) (supplementation of the *Principles*) and Art 1.7 (good faith and fair dealing) in effecting a modification etc of a contract in the circumstances to which those Articles apply.

4. For the reasons given in the Paper I do not propose significant additions to, or alterations of, the current Articles and Comments. The following matters, though, are raised for the purposes of discussion.

(a) Termination for breach:

Should the Principles provide expressly in Art 7.3 for the loss of the right to terminate for breach if the innocent party expressly or impliedly affirms the contract after the time for giving notice to terminate has begun to run?

(b) Limitation Periods:

(i) Should the Principles expressly permit a party to renounce its Draft Article 9 right to invoke the limitation period after that right has accrued and irrespective of whether the right results from the expiration (a) of the general limitation period, or (b) of the maximum limitation period?

(ii) Should the Principles go further and oblige that party to make an election whether or not it renounces or insists upon its right to assert the limitation period?

(iii) Does or should the renunciation of an accrued right have the effect of creating a new general limitation period in respect of the right to which the expired limitation period related?

(c) Set-Off:

It is proposed:

A party, having the right to raise a set-off, may by notice to the other party renounce that right in relation to the claim or claims of the other party that are specified in the notice.

(d) Unilateral modification of agreed terms:

It is proposed:

No express provision be added to the Principles that would, in the absence of agreement, permit unilateral modification of any of the terms of the contract.

(e) Reliance/Inconsistent Behaviour (Estoppel)

The choices available to the Working Group are:

1. *Leave the Principles as they stand without further amendment to the text or the comments, relying upon Arts 1.6(2) and 1.7 to deal with cases of inconsistent behaviour beyond those already provided for specifically.*

2. *Leave the Principles as they stand but (a) add to the Comment to Art 1.7 so as to make explicit what is now implicit, ie that the principle of good faith and fair dealing can be breached by one party resiling from an assumption on which it has induced the other reasonably to act to its detriment should the former be permitted to resile; and (b) add to Comment 2 to Art 1.3 to emphasise that Art 1.3 is subject to Art 1.7.*

3. *Formulate a further mandatory rule (necessarily a derivate of Art 1.7) that deals explicitly with inconsistent behaviour in general terms.*

4. *Formulate such further specific Articles dealing with instances of inconsistent behaviour as are considered to be appropriate and desirable.*