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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

PROGRESSIVE CODIFICATION OF INTERNATIONAL TRADE LAW

Proposed Rules on the (Substantive) Validity of International Contracts (excluding Illegality)

and

Explanatory Report

(prepared by Prof. U. Drobnig, Co-Director of the Max-Planck-Institut für ausländisches und internationales Privatrecht, Hamburg, and by Prof. O. Lando, Director of the Institute of European Market Law, Copenhagen School of Economic and Business Administration)

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Ulrich Drobnig, Hamburg
Ole Lando, Copenhagen

Proposed Rules on the (Substantive) Validity of International Contracts (except on Illegality)

At the Rome meeting in September 1979, the two authors were asked

(1) to review the UNIDROIT Draft of a Law for the Unification of certain rules relating to validity of contracts of international sale of goods, as approved by the Governing Council on 31 May 1972 (text and explanatory report in Revue de droit uniforme / Uniform Law Review 1973 I 60 ss.); and

(2) to supplement those rules by one or more rules dealing with unconscionable contracts.

Although the authors agree on most points, some divergencies of opinion could not be reconciled. Some of these relate to substantive points. But in addition there is one major difference of philosophy affecting the method of drafting: One author wishes for the sake of clarity and predictability to state rules which provide for as much certainty of application as possible. The other is of opinion that under present conditions guidelines such as those which are now being drafted can bring about some, but not a very high de-

gree of foreseeability. He therefore wishes the rules to be framed as legal standards which will leave the court a certain amount of discretion. Such standards, he believes, will be more acceptable to judges facing an international contract than more rigid rules.

Rules or clauses upon which the authors disagree are placed in brackets.

1. The review of the UNIDROIT text has been carried out mainly on the basis of new legislative texts which have been enacted within the last 20 years. The following enactments have been taken into account:

Algerian Civil Code (1975)

Czechoslovakian International Trade Code (1963)

German Democratic Republic Law on International Economic Contracts (1976)

Israel Contracts (General Part) Law (1973)

Netherlands New Civil Code, Books 3 and 6 (1980)

New Zealand Contractual Mistakes Act (1977)

Portugal Civil Code (1966)

In addition to these legislative enactments, the following drafts, compilations or comparative proposals have been taken into account:

USA Restatement of Contracts 2d (1979)

Scottish Law Commission, Memorandum no. 42 on Defective Consent and Consequential Matters (1978)

Rodière, Les vices du consentement dans le contrat (1977).

In addition to inspirations from recent legislation, the authors have taken the liberty of using their personal judgment with respect to the merits or the form of the UNIDROIT text.

2. Artt. 1 - 5 of the UNIDROIT text should be omitted.

a) Art. 1 circumscribed the scope of the proposed law following the model of ULFIS art. 1. This has become "sans objet" in the new framework into which the new rules are to be inserted.

b) Art. 2 allowed the parties to deviate from the uniform law, except in the cases of fraud and threat. These provisions also have become "sans objet" in the new context: On the one hand, party autonomy (art. 2 par. 1) need not be expressly guaranteed in the new framework; and corresponding provisions have not been inserted into the other chapters. On the other hand, the mandatory rule of art. 2 par. 2 has been preserved in essence; see now art. 18.

c) Artt. 3 and 4 dealt with interpretation; they have been replaced by chapter 2 of the proposed "code".

d) Art. 5 gave a rule on the formation of a sales contract. This provision seems to have become unnecessary, since the same result would seem to follow now from ch. 1 art. 7 (1) of the "code".

3. Art. 6 of the UNIDROIT text provides:

> " A party may only avoid a contract for mistake if the following conditions are fulfilled at the time of the conclusion of the contract:
>
> (a) the mistake is, in accordance with the above principles of interpretation, of such importance that the contract would not have been concluded on the same terms if the truth had been known; and
>
> (b) the mistake does not relate to a matter in regard to which, in all the relevant circumstances, the risk of mistake was expressly or impliedly assumed by the party claiming avoidance; and
>
> (c) The other party has made the same mistake, or has caused the mistake, or knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error. "

ad lett. (a): (1) The laws of Algeria (art. 82) and the CSSR (§33), while also using the general criterion of "essentiality", illustrate this term as relating especially to the subject-matter, or the quality of performance, or the person of the other contracting party. A similar approach is used by Portugal art. 251 s. However, all these concrete indications are then conditioned on the parties having regarded them as essential in concreto; other facts may be essential if the parties have regarded them as such. Therefore, the solution of letter (a) not specifying what is to be essential appears to be preferable.

(2) The new American Restatement § 153 combines two criteria: the mistake must affect a "basic assumption on which the contract was made" and it must have "a material effect on the agreed exchange of performances". In effect, this would not seem to differ from the test used by letter (a); and the latter is shorter, appears to be more concrete and is therefore preferable.

(3) As a slight adaptation to the new framework, the word "above" should be omitted. Otherwise, the reference to the principles of interpretation, although unusual, should be retained in order to underline the primacy of interpretation over avoidance (see the Explanatory Report on art. 6).

ad lett. (b): (1) The Netherlands (art. 6.5.2. 11 (2)) and the USA (Restatement §§ 152-153, detailed rules in § 154) expressly confirm this rule.

(2) New Zealand (s. 6 lett. (c)) declares ineffective a contractual term burdening the errans with the risk of his mistake. As a general rule, this appears to go

too far. In many bargains one of the parties assumes the risk of an uncertain contingency. Especially among commercial men this is a sound policy.

(3) As a matter of drafting, we propose a slight redraft which makes it clear that the consideration of all the relevant circumstances only relates to an implied assumption of risk:

> "b) the mistake does not relate to a matter in regard to which the risk of mistake was expressly or, in all the relevant circumstances, impliedly assumed by the party claiming avoidance."

ad. lett. (c): (1) Common mistake is expressly dealt with in the Netherlands (art. 6.5.2. 11 (1) lett. c), New Zealand (s. 6 (a) (ii)) and the USA (Restatement § 152).

The New Zealand extension of the common mistake to cover also the mutual mistake (both parties make a different mistake about the same fact) introduces too fine a distinction. Nor is it necessary since a court would be justified to regard the mutual mistake as a common mistake.

(2) Causation of the mistake by the other contracting party is adopted also in the Netherlands (art. 6.5.2.1 (1) lett. a) and the USA (Restatement § 153).

(3) Knowledge of the mistake by the other contracting party is taken into account by New Zealand (s. 6 (a) (i)); see also infra (4).

(4) Negligent ignorance of the mistake by the other contracting party is adopted by many: CSSR (§ 33 sent. 2), Israel s. 14 (a), the Netherlands, the USA (Restatement § 153) and also the proposal of Rodière (no. 4).

In the Netherlands, knowledge or negligent ignorance of the mistake by the other contracting party are only relevant if that party was obliged to inform the errans (art. 6.5.2. 11 (1) lett. b).

This proviso does not seem to be an improvement because avoidance is not designed to sanction the violation of a duty of information.

(5) In the Anglo-American orbit there is a certain, although diffuse trend to go beyond the catalogue of lett. (c). Israel and the USA envisage as an alternative to the subjective conditions in the person of the other contracting party (lett. (c)) a general clause: performance of the contract must be "unconscionable" (USA: Restatement § 153), or the court, in its discretion, must regard avoidance as being "just" (Israel s. 14 (b)). However, the need for such a clause allowing avoidance for a purely "unilateral" mistake has not been demonstrated. Also, such general clauses tend to create uncertainty.

d) Another qualification has been introduced in New Zealand (s. 6 (b)): the mistake must have resulted at the time of the contract in "a substantially unequal exchange of values". It is possible that this criterion is implied in lett. (a) of the UNIDROIT text, or that in effect it does not differ from it. If the New Zealand test were to go farther, it would not be acceptable.

e) Conclusion: Apart from the formal amendments suggested supra ad lett. (a) sub (3) and ad lett. (b) sub (3), the text of art. 6 should be maintained; see now art. 2.

4. Art. 7 of the UNIDROIT text provides:

> " 1. A mistake of law shall be treated in the same way as a mistake of fact.
>
> 2. A mistake in the expression or transmission of a statement of intention shall be considered as the mistake of him from whom the statement emanated."

a) The equivalence of a mistake of law with a mistake of fact, as laid down in par. 1, has been confirmed by Algeria, Israel, New Zealand,and the USA. There is no reason to amend the substance of this provision.

b) Also the rule in par. 2 concerning a mistake in expression or transmission has been widely confirmed, namely by the CSSR, the GDR, Portugal, and the USA; so also Rodière.

On the other hand, in Algeria (art. 84) "simple" writing mistakes and mistakes in calculation do not affect the validity of the contract, but are to be corrected. If "simple" alludes to mistakes that are obvious to the other party, especially if they affect the written version of an orally discussed and agreed contract, this rule is to be justified as one of interpretation, where the parties' common intention prevails over an erroneous writing (see ch. 2 art. 15 par. 1). It would then come close to the equity remedy of reformation which is confirmed in the USA (Restatement § 155) if a written contract does not reflect the agreement of the parties.

c) On the other hand, art. 27 of the U.N. Convention on contracts for the International Sale of Goods of 1980 (CISG) provides that, inter alia, an error in the transmission of a communication by one party to another party "does not deprive that party of the right to rely on the communication". In other words, the risk of mistake in transmission is placed upon the receiver, and not on the sender, as under art. 7 (2). However, it would seem that the devolution of the risk of transmission on the receiver in the U.N. Convention expresses a specific policy underlying art. 27. Even

the communication fails to reach the addressee, the sender may rely upon it, as CISG art. 27 expressly provides. This special rule is, however, irreconcilable with the general principles on the formation of a contract which require that offer and acceptance must be received to become effective (CISG artt. 15 (1) and 18 (2); supra ch. 1 artt. 5 (1) and 6 (1)). Under the general rule, therefore, offer and acceptance travel upon the risk of the sender. It is therefore consistent to place also the risk of mistake upon the sender, as art. 7 (2) of the UNIDROIT text does.

d) In conclusion, there is no need to amend the substance of art. 7. However, for drafting reasons the first paragraph can be omitted since it will be incorporated, in substance, into a definition of mistake (see infra no. 5). Paragraph 2 forms now art. 3.

5. Art. 8 of the UNIDROIT text provides:

> " A mistake shall not be taken into consideration when it relates to a fact arising after the contract has been concluded. "

a) In the Netherlands (art. 6.5.2. 11 (2)) and the USA (Restatement, Comment a on § 151) the same rule has been laid down.

b) One of the authors has objected that the present text of art. 8 may give rise to the impression that any remedy

based upon supervening events is to be excluded. Of course, this is not intended. To forestall such a conclusion, an express clause could be inserted.

However, it is more elegant and briefer to redraft the provision as a definition of mistake. That would make it possible to incorporate also present art. 7 (1).
Proposal:

> "Mistake is an error relating to facts or to law existing when the contract was concluded."

See now art. 1.

5. Art. 9 of the UNIDROIT text provides:

> " The buyer shall not be entitled to avoid the contract on the ground of mistake if the circumstances on which he relies afford him a remedy based on the non-conformity of the goods with the contract or on the existence of rights of third parties in the goods. "

a) The countries of the world remain divided as to whether or not avoidance for mistake should be allowed even if the buyer has a remedy based on breach of warranty for the goods bought: The GDR only allows the latter remedy (Kommentar zum Gesetz über internationale Wirtschaftsverträge (1978), note 4 on § 13), whereas in the USA both remedies are allowed (Restatement, Comment g on § 294).

b) In view of the unaltered division of opinion, one author is of opinion that the present solution of art. 9 should be preserved.

c) In his view, however, the provision should now be absolved from its sales background. It should be made clear that no contracting party is entitled to avoid on the ground of mistake if the same circumstances afford him a remedy for breach of contract. Breach of contract is meant here in the wide sense as employed in the new Convention on Contracts for the International Sale of Goods of 1980 (art. 61 ss.) and not in the narrow sense attached to it in some countries such as Germany (where a breach of warranty is not considered a breach of contract). The redraft should also make clear that avoidance for mistake is excluded if general remedies for breach of contract would have been available, even if now they do not afford a remedy (e.g. because of lapse of time).

d) Proposal:

["A party shall not be entitled to avoid the contract on the ground of mistake if the circumstances on which he relies afford, or could have afforded, him a remedy for breach of contract."] (See now art. 4)

e) The other author is of opinion that the consequences of the rule proposed by the first author are incalculable. This rule now comprises all contracts. The other author would prefer to defer the matter until the chapter on breach of contract has been finished. If in that chapter the mistaken "buyers" of goods, services, risks etc. are granted remedies which place them in the same position as they were before the contract was made the rule proposed by the first author might be considered. If not, the possibility of resorting to both kinds of remedies should be considered.

7. Art. 1o of the UNIDROIT text provides:

> " 1. A party who was induced to conclude a contract by a mistake which was intentionally caused by the other party may avoid the contract for fraud. The same shall apply where fraud is imputable to a third party for whom the other party is responsible.
>
> 2. Where fraud is imputable to a third party for whose acts the other contracting party is not responsible, the contract may be avoided for fraud if the other contracting party knew or ought to have known of the fraud."

a) The essence of fraud is described in par. 1 sent. 1; fraud is here defined as the intentional causing of a mistake by the other party. Even shorter descriptions, namely merely the (equivalents of the) term "fraud" are used in the CSSR (§ 27 (1)) and in the GDR (§ 13 (4)).

Some countries, on the other hand, offer broader definitions. Thus Israel s. 15, while essentially in accord with art. 1o par. 1 sent 1, adds that fraud includes the non-disclosure of facts which according to law, custom or the circumstances the other party should have disclosed. Similarly, Algeria art. 86 par. 2 expressly mentions "intentional silence". The Netherlands (art. 3.2. 1o (3)) mention intentional wrong information; intentional non-disclosure of a fact that should have been disclosed; or other artifices. The USA (Restatement §§ 162-172) give a very casuistic catalogue.

It would seem advisable to deal expressly with the case of intentional silence in a separate phrase. It is therefore necessary to restrict present sentence 1 to acts; it should also be made clear that mere "puffing" is not fraudulent. Proposal:

> "1. A party who was induced to conclude a contract by a mistake which was caused by the other party's fraudulent misrepresentation may avoid the contract. The same applies if the mistake was caused by the other party's fraudulent non-disclosure of circumstances which in the situation he was obliged to disclose."

b) The same rule as in art. lo par. 1 present sent. 2 has been adopted in Israel (s. 15) and the USA (Restatement, Comment e on § 164; Restatement on Agency 2d § 259). The GDR (§ 13 (4)) is somewhat narrower because it requires that the third person has acted upon the other party's mandate. The present rule should be retained.

One of the authors has asked why the same rule does not cover also cases of mistake, threat and unequal bargaining power. Indeed, it expresses a general principle, and there is no reason to restrict it to fraud. Accordingly, we propose the following general rule:

> "Where a fraud, a threat, an abuse of unequal bargaining power or a party's mistake is imputable to, or is known or ought to be known by, an agent of the other party, the contract may be avoided under the same conditions as if it had been concluded by the other party himself." (See now art. lo).

c) The same or essentially the same rule as in art. 1o present par. 2 is now also found in Algeria (art. 87), the CSSR (§ 27 (1) sent. 2), the Netherlands (art. 3.2.1o (5)) and Portugal (art. 254 (2)).

On the other hand, the American Restatement (§ 164 (2)) differs markedly: Knowledge or negligent ignorance of the fraud by the other party as such is irrelevant; but avoidance is excluded where the other party "without reason to know of the misrepresentation either gives value or relies materially on the transaction." In other words, avoidance is possible even if the other party did not know about the third person's misrepresentation, unless

the other party relied on the transaction. However, is this solution equitable? Why should the innocent other contracting party lose the benefit of its bargain before it has executed the contract, but not thereafter?

We therefore propose to retain the present rule.

now art. 5.

8. Art. 11 of the UNIDROIT text provides:

> " A party may avoid the contract when he has been led to conclude the contract by an unjustifiable, imminent and serious threat. "

a) For the definition of threats we find the same division of countries as for frauds: the East European Socialist countries and Israel use similar formulas as art. 11: GDR § 13 (4): "threat"; Israel s. 17 (a): "duress, force or threats"; CSSR § 27 (1): "threat causing justified anxiety".

b) Most other countries give more detailed rules. Some of these describe the objects of a threat: a disadvantage to the person or the goods of the contracting party or a third person (Netherlands art. 3.2.1o (2) and Portugal art. 255 (2)); similarly Algeria art. 88 (2), except that the third person must be close to the contracting party.

Others relate to the seriousness of the threat. Thus Algeria specifies that the sex and age, the social status and the health of the person threatened, as well as all

other circumstances must be taken into account (art. 88 par. 3). The USA (Restatement § 175 (1)) offer an alternative test: the victim must not have had any reasonable alternative.

It does not seem useful to enumerate the possible objects of a threat. This is the less useful if decisive weight is attached to the seriousness of a threat. Here the American formula offers a specific and clear test which should be adopted for art. 11. However, one of the authors is of the opinion that both the present text and its amendment use too objective a test: The shock caused by a threat may blur the judgment of the person threatened so that he cannot see the "reasonable alternative". The other author thinks that it would be wrong to introduce a subjective criterion because this would endanger the security of transactions. We mark this disagreement by inserting the words "in his judgment" in brackets.

> "A party may avoid the contract when he has been led to conclude it by an unjustifiable threat which [,in his judgment,] is so imminent and serious as to leave him no reasonable alternative."

c) Some countries have also specified the "unjust" or "improper" character of a threat. Israel (s. 17 (b)) and Portugal (art. 255 (3)) clarify that a person's "bona fide" (Israel) announcement of the "normal" exercise of a right does not constitute a threat. The American Restatement (§ 176 (1)) specifies some cases of "improper" threats: if either the threat itself or the threatened evil is a crime or a tort or a criminal prosecution; or the bad faith warning to bring a civil

process or to breach a contract with the recipient. On the other hand, the CSSR (§ 27 (2)) declares unjustified a threat which, although justified in itself, is intended to achieve an improper purpose.

It appears desirable to take into account the foregoing situations because they occur not infrequently in international trade. We therefore propose to add the following phrase:

"In particular, a threat is unjustified if the act or omission with which the promisor has been threatened is unlawful in itself or, although lawful, it is unlawful to use it as a means to obtain the promise."

d) Since art. 11, as contrasted to art. 6 and 10, does not mention the author of the threat, it is irrelevant whether it emanates from the contracting party or a third person. Recent legislation does not so equate third persons with the contracting party. Rather, the same or similar criteria are used as for fraud committed by a third person (see art. 10 par. 2 and on this supra 7 sub c).

Algeria art. 89; CSSR § 27 (1) sent. 2; GDR § 13 (4); Israel s. 17 (a); Netherlands art. 3.2. 10 (5); USA Restatement § 175 (2). Only Portugal art. 256 is in accord with art. 11.

In spite of this overwhelming dissent we propose to retain the present solution of art. 11. It is based on the idea that a threat is a more aggravating inroad on contractual self-determination than a fraud. Avoidance of the contract because of threat by a third person is justified even if the other contracting party is ignorant and innocuous, since the latter has profitted from the threat.

See now art. 6.

9. Abuse of unequal bargaining power

Besides threat, abuse of unequal bargaining power should lead to the avoidance of a contract. This is in accordance with the law of several countries.

In West German law the provision in the Civil Code on abuse of unequal bargaining power was amended in 1976. § 138 (2) of the Code now provides that a contract is null and void if a party has abused the distress, inexperience, poor judgment or considerable lack of willpower of another person to receive or to be promised either for himself or for somebody else a performance which is out of proportion to the consideration given or offered. A weak bargaining position in itself is not sufficient to hold the contract void. There must have been one of the enumerated "weaknesses". These, however, are more numerous and will include more situations of a weak bargaining power than before the amendment in 1976 (see Palandt, Bürgerliches Gesetzbuch. Kommentar, 36 ed. München 1977, § 138 Anm. 4 p. 115).

Under Danish law contracts may be held unenforceable if they were made under undue influence. § 31 of the Contract Act, as amended in 1975, provides that if a party has taken advantage of the grave economic or personal difficulties, lack of insight, improvidence or dependency of another person to obtain or stipulate a performance which is in obvious disproportion to the consideration given or promised or for which no consideration is given or promised, then the promise or the performance shall not be binding upon the weak party (see Ussing, Aftaler på formuerettens område, 3 ed. Copenhagen 1950, § 16 p. 146 ff.) The scope

of application of the provision has been widened in 1975 and now covers more cases of weakness than formerly in order to break with the narrow use the courts had made of § 31.

In English law a provision made under undue influence has been held invalid in equity if the bargain was unconscionable. Undue influence has been described as "some unfair and improper conduct from a person by which he has exerted an influence over another person which prevents that person from exercising an independent judgment", see Fry v. Lane (1888) 4o Ch.D. 312, 322. Chitty (-Atiyah) on Contracts I, 24. ed. London 1977, no. 456. In a recent case it has been said that relief should be given to "one who without independent advice enters into a contract upon terms which are very unfair or which transfer property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires or by his own ignorance or inferiority coupled with undue influence or pressure brought to bear on him by or for the benefit of the other", see Lloyds Bank v. Bundy [1975] Q.B. 326; Chitty (-Atiyah) no. 458.

The courts of the United States also apply the English doctrine of undue influence. There is a stronger tendency in America than in England to set aside or modify contracts in cases of "great disparity of mental ability in contracting a bargain" and abuse of another person's distress (see Corbin on Contracts I (Minnesota 1963) § 128).

§ 2.3o2 of the American Uniform Commercial Code (UCC) which applies to sales makes it possible for the courts to refuse enforcement of contracts or contract clauses which were unconscionable at the time they were made or to limit their application. This rule which has enacted "the moral sense of the Community into the law of commercial transactions", (see Jones v. Star Credit Corp., 59 Misc. 2d 189, 298 N.Y. 2d 264. Anderson, Uniform Commercial Code, 2. ed. 197o (p. 39o) with Supplement 1978, see also Uniform Commercial Code, Official Text, 1972, p. 62), has been used to strike down contracts in which the cost-price disparity was so excessively high that it "shocked the conscience of the court". In all the cases known it was obvious from the facts that the buyer had been in an inferior bargaining position.

Art. 9o of the Algerian Civil Code of 1975 provides that at the request of a party the judge may void a contract or reduce his obligations if they are grossly disproportionate to the advantage which he derives from the contract or to the obligations of the other party, and if it is shown that he was exploited by the other party because of his obvious improvidence or of an unrestrained passion.

S. 18 of the Israel Contracts Law (General Part) 1973 also deals with extortion: Where a party has entered into a contract in consequence of the other party or a person acting on his behalf, taking advantage of his distress, mental or physical weakness or inexperience, and the terms

of the contract are less favorable to an unreasonable degree than is customary, he may rescind the contract.

Book 3 chapter 2 of the Netherlands Civil Code 1980 treats in art. 1o par. 4 abuse of circumstances. It exists where a person knows or should have known that another person has been induced to make a contract by special circumstances such as distress, dependence, improvidence, mental derangement or inexperience although in the light of what he knew or ought to have known he should have abstained from concluding the contract.

As has been seen the causes of weakness vary from one legal system to the other.

Dependence is mentioned in Denmark, Netherlands and Israel and in the Common Law. Economic distress and urgent needs are found in West Germany, Denmark, Netherlands, Israel and in the Common Law, all of which also list ignorance and lack of bargaining skill. Improvidence we find in the laws of Algeria, Netherlands and Denmark; the West German Code mentio poor judgment. It also lists lack of willpower, and the Netherlands Code mental derangement, the Israel act mental ak-ness and the Algerian Code an unrestrained passion. In the Netherlands, the weaknesses mentioned are illustrations only.

As in most of the other legal systems we find it appropriate to limit the application of the rule to certain cases of weakness. They are to be found in the weaker person's critical situation: dependence, economic distress and urgent needs, and in his lack of personal capabilities: improvidence ignorance, inexperience and lack of bargaining skill. We do

not favour a general rule on abuse of circumstances. It should, for example, still be possible to avail oneself of an - even unreasonably - advantageous market situation.

On the other hand, we have not included mental derangement as have the Israel and Netherlands laws. A mental disability should be treated as an incapacity, and the consequence, it is submitted, may be invalidity of the contract even in cases where there was no abuse and no unreasonable disequilibrium. Such rules should be established by a person's personal law, and they should be observed in other countries under the rules of private international law.

In accordance with the recent rules in countries such as Israel and the Netherlands and in contrast to the more traditional rule followed in most countries, we regard avoidance, and not voidness, as the proper sanction. In our view, abuse of unequal bargaining power should not be treated differently from threat.

Proposal:

> "A party may avoid a contract when the other party has taken advantage of his dependence, economic distress or urgent needs, or of his improvidence, ignorance, inexperience, or lack of bargaining skill, to obtain terms which make the contract as a whole unreasonably advantageous for the other party and unreasonably disadvantageous for him." (See now art. 7).

This rule permits a party to avoid a contract in cases where the other party has abused an unequal bargaining power

to obtain terms which render the contract as such unreasonably disadvantageous for the weaker party and unreasonably advantageous for the stronger party. The rule only applies in cases of abuse of the circumstances mentioned, and it is the contract as such, and not one or more of its terms which is to be judged when the advantage and disadvantage are to be assessed. The contract must be both unreasonably disadvantageous for one and unreasonably advantageous for the other party. If a party abuses the other party's dependence to sell him rare goods for a price which is low but not unreasonable, the contract cannot be avoided under the provision although it might confer an unreasonably great advantage upon the buyer. And if a person in distress sells goods for an unreasonably low price the provision is not applicable if the purchaser derives no great advantage from the bargain. If the bargain is unconscionable it may also be covered by the rule on unconscionability, to be proposed infra no. 1o.

1o) Unconscionable disequilibrium

There is, and has always been, a need to make it possible for the courts to police explicitly the contracts or the contract clauses which are unconscionable. In many countries such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance, by stating the contract to be lacking it's "cause" or the contract clause to be contrary to public policy or to the dominant purpose of the contract. A court must be able to pass directly on the unconscionability of the contract or a particular clause therein and to set it aside or to mitigate it.

Several legal systems show more or less clearly a tendency in this direction.

The French Civil Code has no general rule which invalidates unconscionable contracts or contract clauses (see Ferid, Das Französische Zivilrecht, München 1971, 2 B.2, p. 429). However, the French courts have held contracts for sale of goods invalid for lack of cause in accordance with art. 1131 of the Civil Code if the price was scandalously low (dérisoire) (see Planiol & Ripert, Traité pratique de droit civil français VII, Obligations, 2. ed. Paris 1952, p. 262). This rule may also apply to other contracts.

Under § 138 par. 1 of the West German Civil Code contracts and other legal acts which are against the generally accepted moral standards are null and void (see Max-Planck-Institut für ausländisches und internationales Privatrecht, Die materielle Gültigkeit von Kaufverträgen I, Berlin-Tübingen 1968, p. 147). § 242 of the Code provides that the debtor must perform his obligations in accordance with the requirements of good faith. These rules have been considered by the German courts as legal standards of broad application and they have both been invoked when the courts struck down unconscionable contracts and contract clauses (see Soergel-Siebert (-Knopp), Bürgerliches Gesetzbuch II, 10. ed. Stuttgart 1967, § 242 Anm. 97). It is uncertain whether a gross value-price disparity, be it an excessively high or low price, will be sufficient to have a contract set aside under § 138 par. 1 (see Soergel-Siebert (-Hefermehl) § 138 Anm. 42). However, these legal standards and especially § 242 are applied in accordance with the prevailing moral norms of each epoch. In the 1970s

statutes such as the Standard Form Contract Act 1976 (see Ulmer, Brandner, Hensen, AGB-Gesetz, 2. ed. München 1976, 18-19), and amendments to the Civil Code have been made which have raised the demands on contractual fairness and equilibrium.

§ 33 of the Danish Contract Act is a general clause (see Ussing, Aftaler på formuerettens område, 3. ed. Copenhagen 1950, § 18 p. 169). It provides that an act which should otherwise be considered valid is not enforceable when owing to circumstances which were present at the time of the making of the act, it would be contrary to generally accepted concepts of honesty and fairness to enforce it with knowledge of these circumstances, and the person who invokes the act must be presumed to have had this knowledge. This provision which might have been used to set aside unfair bargains has very rarely been used for this purpose. There has in Denmark been a growing need to invalidate unfair contracts and contract clauses to a larger extent. The new version (1975) of § 36 of the Contract Act should meet this need. It provides:

"(1) A contract may be set aside wholly or in part if it is unreasonable or contrary to honest conduct to enforce it. This also applies to other legal acts.

(2) In making such a decision regard must be had to the circumstances prevailing at the making of the contract, to its terms and to subsequent circumstances."

Much case law on the application of § 36 has not yet been reported. § 36 has, however, widened the application of the doctrine of unconscionability in Denmark. It seems that § 36 may be applied to set aside a contract if the value-price discrepancy is shocking to conscience of the judge, see Østre Landsret, Ugeskrift for Retsvaesen 1977, p. 798.

In 1976 § 36 of the Swedish Contract Act was similarly changed.

It is doubtful whether the English courts will set aside or modify a bargain merely because of an unconscionable disequilibrium. However, recent legislation in the United Kingdom has shown considerable interest in avoiding unfair contracts. Thus several exemption clauses are invalid under the Unfair Contract Terms Act 1977 unless they satisfy the requirement of reasonableness; in consumer contracts some are invalid per se. The American doctrine of unconscionability is known in England and recorded in an English text book (see Cheshire & Fifoot, Law of Contract, 9. ed. London 1976, p. 288, citing Dawson, 45 Mich. L.R. 253). Although the judges of England are known for their independence of the legislator's policies and of foreign doctrines some judges like Lord Denning seem to show concern for contractual fairness.

To an increasing extent the courts of the United States operate with a general principle according to which unconscionable contracts are unenforceable. Thus, in one case a Federal Circuit Court denied specific performance of a contract which was "too harsh a bargain and too onesided an agreement to entitle the plaintiff to relief in a court of conscience", see Campbell Soup Co. v. Wentz, 172 F.2d 80 (3 Cir. 1948). The doctrine of unconscionability was used before the enactment by the states of the Uniform Commercial Code, see e.g. in Henningsen v. Bloomfield Motors Inc., 161 A.2d 69 (N.J. 1962). § 2-302 of that Code has probably increased its use, see Friedman, Int.Enc.of Comparative Law, Vol. VII, Ch. 3, p. 19-21.

Today all the states of the union except California, North Carolina and Louisiana have enacted § 2.3o2 UCC which in subparagraph 1 provides: "If the court as a matter of law finds the contract to have been unconscionabl at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the a plication of any unconscionable clause as to avoid any unconscionable result."

or any clause of the contract

The rule only applies to the sale of goods. However, the Restatement 2d of Contracts 198o § 2o8 has made the pri ciple stated in UCC § 2.3o2 into a general standard using almost the same wording as the UCC.

The differences between the systems treated are not gre A value-price disparity or some other element which up- sets the equilibrium of the performance and the counter per formance is, even if it is considerable, insufficient for refusing the enforcement of a contract. Only if the disequ librium is of such a size that it shocks the conscience of the court, German, American, and Scandinavian courts may ap their general clauses on unconscionability, and so will the French courts if the price is "dérisoire".

against

As mentioned before the methods of some other countries to police unconscionable contracts and contract clauses by way of covert techniques such as adverse construction of language should be replaced by a rule enabling the court to pass directly on the unconscionablility of the contract.

Proposal:

"A party may avoid or have revised a contract if at the time of the making of the contract there

are an unconscionable disparity between the obligations of the parties or other unconscionable contract clauses which grossly upset the contractual equilibrium." (see now art. 8)

As the term "unconscionable" denotes, the requirements for the application of the rule are to be strict. The rule does not aim at introducing the concept of "contractual justice" into each contract. The permissible extent of the disequilibrium would be larger than under [9] The contractual equilibrium will have to be grossly upset and the unfairness so great that it will shock the conscience of the court.

The unconscionability must exist at the time when the contract is made. A contract or a contract clause which, though not unconscionable when made, has become so afterwards may be revised or set aside under the rules on frustration ("imprévision", Wegfall der Geschäftsgrundlage) treated in chapter X on breach of contract.

[9] the preceding provision relating to abuse of an unequal bargaining power.

11. Art. 12 of the UNIDROIT text provides:

" 1. Avoidance of a contract must be by express notice to the other party.

2. In the case of mistake or fraud, the notice must be given promptly, with due regard to the circumstances, after the party relying on it knew of it.

3. In the case of threat, the notice must be given promptly, with due regard to the circumstances, after the threat has ceased. "

a) As to the form of avoidance, art. 12 par. 1 merely requires an express notice to the other party. Expressly so Israel (s. 2o) and apparently also the CSSR.

However, some recent texts attach greater weight to a judicial proceeding; they require therefore the bringing of an action for the avoidance of the contract, though in various forms.

In the GDR and the Netherlands the necessity of an action depends upon whether or not the other contracting party objects to the notice of avoidance. In the GDR (§ 14 (2)), if there is no objection within one month, the avoidance is regarded as agreed; but if there is an objection, the party wishing to avoid must bring action within three months. In the Netherlands (art. 3.2. 14 (2)), a simple notice suffices if the avoiding party has not yet performed its promise. Otherwise, as in the GDR, the notice only becomes effective if the other party does not object;

but no time limit has been fixed for the objection, nor for the action for avoidance which then becomes necessary (art. 3.2.15 (2)).

New Zealand (see ss. 6-7), Portugal (see art. 287) and Rodière (nos. 6, 15, 23) always require an action, following the Romanic tradition.

In substance, these various approaches are less diverging than appears at first sight. All agree in essence that no action is necessary if the other party agrees, or at least fails to object, to the avoidance. The only deviation is in the GDR because it sets a time limit of one month for making the objection. Certainly, such a time limit helps to clarify the situation. Under the general approach of the draft which allows avoidance only when the other party is in some way inplicated in the avoiding party's defective consent it seems also equitable to charge him with the burden of objection and of a time limit for it. On the other hand, a time limit imports a rigidity which does not seem warranted here. If the other party does not agree with the avoidance, it will in its own interest object as quickly as possible to it. Any unreasonable delay, perhaps motivated by speculative reasons, would probably be regarded as an implied agreement, precluding a subsequent objection. We therefore do not propose to set a time limit for the objection.

rule

Nor do we support the Dutch idea which seems to exclude an objection by the other party against the avoidance if the avoiding party has not yet performed its promise. Such a rule would only be justified if all notices of avoidance were well founded. But certainly there are also unjustified notices, and the other party must be able to object to these

and to provoke a court decision on the validity of the contract.

There is practically unanimity again that an action is unavoidable where the other party has objected to the notice of avoidance.

The only question that remains is whether the guidelines of practical acting set out above need to be laid down expressly. We do not think so.

b) One of the authors thinks that an express avoidance would be inappropriate vis-à-vis that contracting party who has committed a fraud, made a threat or abused an unequal bargaining power.

A person should not be permitted to reap the fruits of a tortious act or a crime just because his co-contractant did not give notice in time. And a party should not be held to the contract obtained by fraud, threat or usury when under the law applicable to the tort or the criminal offence involved his co-contractant may still be sentenced to pay damages or to go to jail.

If it is doubtful whether the other party's act was unlawful the aggrieved party will, as time passes, face the growing insufficiency of evidence, and this should encourage him to raise the issue in time. In other words, for the clear cases there should be no time limit for avoiding the contract, except those provided in the statutes of limitation; for the doubtful cases the fading evidence which time and oblivion produces will automatically set a time limit.

Express notice of avoidance should only be demanded in case of mistake and unconscionability and in the cases of fraud, threat or abuse of unequal bargaining power not exercised by, and unknown to, the other party.

The other author is of the opinion that in the interest of clarity and legal security an express notice of avoidance should be demanded in all instances of defective consent. There are many cases in which it is doubtful whether a fraud has been committed or mere puffing; whether there was a duty of disclosure or not; or whether some threat was unjustified or not. In all of these fringe situations it is relevant to know whether the party adversely affected has in its own judgment suffered or not. The necessity of notice also forestalls attempts by the affected party to speculate against future unfavourable movements of the market and to invoke a threat only after the market has taken an unfavourable turn. This author would maintain the present text, whereas the other proposes an alternative text, see infra sub d).

c) According to art. 12 par. 2 and 3, notice of avoidance must be given "promptly, with due regard to the circumstances .. The GDR (§ 14) sets the same requirement. Most other recent legislation is more lenient.

Some countries have laid down fixed terms: one year in the Netherlands (for a judicial action of avoidance, art. 3.2. 17 (1) lett. b) and c)) and in Portugal (art. 287 (1)); five years according to the proposals of Rodière (nos. 7 (1), 16, 24); and lo years in Algeria (art. lol (1)). Such time limits appear to be too long for international trade.

In the Netherlands (art. 3.2. 18 (2)), the other party may abbreviate the term of one year by setting to the party who is entitled to avoid an ultimatum to decide within a reasonable period whether it wishes to bring the action for avoidance; if it remains silent, the action becomes inadmissible. However, in international trade it should not even be left to the other party to provoke an early decision on avoidance. The initiative for prompt avoidance should be left to the party who is entitled to avoid.

On the other hand, Czechoslovakia and the Netherlands (for a notice of avoidance as contrasted to an action) do not provide for any time limit, which in the view of one of the authors produces uncertainty.

Israel (s. 2o) and the USA (Restatement § 381) use the test of a "reasonable time" and the Restatement (§ 381 (3)) even takes the trouble of enumerating factors which are relevant in determining the reasonableness, scil. whether the avoiding party has, or could have, speculated in the meantime; whether the other party has, or could have, justifiably relied upon the validity of the contract; whether its conduct has contributed to the delay; and whether the one or the other party has faultily produced the ground for avoidance. We think that the requirement of a "prompt" notice is indeed too rigid. We therefore propose to replace it by the test of a "reasonable time".

d) For technical reasons of drafting, we suggest to combine par. 2 and 3, as follows:

"2. The notice must be given within a reasonable time, with due regard to the circumstances

a) in the case of mistake, fraud or unconscionability, after the avoiding party knew of it;

b) in the case of threat or abuse of unequal bargaining power, after the avoiding party has become capable of acting freely."

See now art. 13.

e) The alternative proposal:

"In case of mistake and unconscionability and in the cases of fraud, threat or abuse of unequal bargaining power not exercised by, and unknown to, the other party avoidance of the contract must be given by notice to the other party within reasonable time."

(See alternative art. 13)

12. Art. 13 of the UNIDROIT text provides:

" 1. In case of mistake, any notice of avoidance shall only be effective if it reaches the other party promptly.

2. In any event, the notice shall only be effective if it reaches the other party within two years after the conclusion of the contract in the case of mistake or within five years after the conclusion of the contract in the other cases."

a) In par. 1, the last word "promptly" should be replaced by the words "within reasonable time", in accordance with the amendment proposed for art. 12 (see supra no.11 sub c) and d)).

b) Art. 13 (2) supplements art. 12 (2) and (3) by setting absolute time limits for the notice of avoidance of two and five years, respectively.

Some countries, such as Israel, the Netherlands, and th USA, do not have any preclusive periods of time. However, it seems preferable to fix some point in time after which the validity of the contract can no longer become subject to doubt.

Some countries fix a uniform time limit for all grounds of avoidance. This time limit varies from two years in the GDR (§ 14 (3)) up to 15 years in Algeria (art. 101). For international trade the shorter period of two years would certainly, in general, be preferable. It should be retained for cases of mistake. However, fraud and threat are evil acts and torts committed by the other party; therefore some punitive element is justified. It is conceivable that at least a fraud is not discovered by the defrauded party within two years of contracting. Therefore the longer period of five years appears to be justified in these cases and should be retained.

c) One author wishes to raise the question whether it is appropriate to set statutory limitations in rules which are intended become guidelines and not statutes. When not incorporated or coordinated with other provisions in the national legislations such time limits may come in conflict with national time limits set fo criminal prosecution and for actions in tort. It might therefore preferable to leave the time limits to the national law applicabl

d) The Netherlands (art. 3.2.17a) and Portugal (for unperformed contracts, art. 287 (2))allow to invoke avoidance at any time in the form of a procedural objection to an action which is based upon the voidable declaration. But it is difficult to see why a notice of avoidance should be dispensed with; otherwise the validity of the transaction may be put in doubt during an unlimited period of time, and this does not seem desirable.

e) We conclude that art. 13 should be retained subject to the modification proposed supra sub a); see now art. 14.

If time limits are to be provided

13. Art. 14 of the UNIDROIT text provides:

" 1. Notice of avoidance shall take effect retroactively, subject to any rights of third parties.

2. The parties may recover whatever they have supplied or paid in accordance with the provisions of the applicable law.

3. Where a party avoids a contract for mistake, fraud or threat, he may claim damages according to the applicable law.

4. If a mistake was at least in part the fault of the mistaken party, the other party may obtain damages from the party who has avoided the contract. In determining damages, the court shall give due consideration to all relevant circumstances, including the conduct of each party leading to the mistake. "

a) The retroactive effect of an avoidance of the contract is generally confirmed by recent legislation.

GDR § 15 (1); the Netherlands art. 3.2. 15 (2); Portugal art. 289 (1); also proposals Rodière nos. 8, 17, 25.

b) The only major dissenter is New Zealand for mistakes. Sect. 7 (3) - (6) empowers the court before which the action for avoidance must be brought to make any order in its discretion, "as it thinks just". In particular, the court may cancel the contract or validate it wholly or in part or amend it; or it may order restitution of performances or payment of damages; or it may vest any property that was the subject of the contract in any party; and any order may be made upon such terms and conditions as the court thinks fit. This unlimited judicial discretion is incompatible with the system of extra-judicial avoidance adopted here. But even for cases of a court intervention such broad discretionary powers are hardly compatible with the function of courts as conceived in the Civil Law countries. It also prevents the parties from calculating the possible outcome of litigation. We cannot recommend this solution.

c) Another deviation is to be found in the Netherlands (art. 3.2.17b) and in the USA (Restatement § 381 (2) sent. 2). These countries, in effect, preclude avoidance if the contract has been so far performed or the circumstances have otherwise so changed that avoidance would be inequitable (USA); or if the effects of a contract that have already realised can be redone only with difficulties (the Netherlands). Under these circumstances, avoidance is excluded in the USA, while in the Netherlands a judge may exclude or limit the nullity of the

contract. In the USA, a further condition is the adequacy of compensation by damages; in the Netherlans, the judge is empowered to order a compensatory payment to the party who would have been entitled to avoidance. The American solution is patterned upon an extra-judicial declaration of avoidance, while the Dutch solution must rely on court intervention. The circumstances envisaged by the two provisions appear to be extreme ones which will only rarely occur. It does not seem possible or useful to give prescriptions for them in an international regulation. The solution of such extreme cases must be left to general hardship clauses which every national legal system contains and which also an international regime will have to offer.

d) One of the authors thinks that the wording of art. 14 (1) is not quite fortunate since it relies on the notice of avoidance only without taking into account possible litigation about its validity; it also leaves open the fate of the contract. He therefore proposes the following new version:

> "1. If the other party does not object to the notice of avoidance or if it is otherwise established that the avoidance is effective, the contract is avoided retroactively, subject to any rights of third parties. "

The other author prefers the UNIDROIT text.

e) Several recent enactments deal with partial invalidity in general or with partial avoidance in particular. Where only some portion of a contract is invalid, this invalidity only affects the whole contract if this according to its character, contents or the surrounding circumstances would not have been concluded without the affected portion (Algeria art. 1o4; CSSR § 29; Portugal art. 292). These rules apply also to cases of partial avoidance.

Israel (s. 19) and the USA (Restatement § 383) have special rules for partial avoidance. That is allowed in case of a severable contract by Israel's main rule; if, however, the avoiding party would not have concluded the contract but for the avoiding ground, it has the choice of avoiding either the portion of the contract affected by the defect or the whole contract. The USA (Restatement § 383), on the other hand, limit partial avoidance to cases "where one or more corresponding pairs of part performances" have been fully performed by one or both parties. In this case, the rest of the contract can be avoided.

An illustration of a (possible) part avoidance is furnished by a recent decision of the Swiss Federal Tribunal (7 July 197o, BGE 96 II 1o1). Vendor and purchaser of several parcels of real estate had assumed that 12 homes could be built on the estate, whereas in fact, due to building restrictions, only eight could be erected. The Tribunal held that a part avoidance of the contract is possible if the parties, had they known the true situation, would have contracted on the basis that eight homes could be built; otherwise the contract would be completely voided.

All these various rules relate to severable contracts. The possibility of restricting avoidance to certain terms of an unseverable contract will usually destroy the balance between the parties' obligations under the contract and is therefore inadmissible.

The wording of a rule dealing with part avoidance should make it clear that there is a presumption for an unseverable contract, because this would seem to accord best with practical experience. Therefore that party who is interested in

limiting avoidance to a severable portion and in maintaining the rest of the contract, must prove the severability of the contract.

It is proposed to deal now expressly with part avoidance, as follows:

> "2. If the ground of avoidance affects only part of a severable contract, avoidance is limited to this part of the contract if, giving due consideration to all circumstances of the case, it is reasonable to uphold the contract."

This new rule should be inserted as a separate paragraph after the revised version of art. 14 (1). See now art. 15. Present par. 2 - 4 of art. 14 should form new provisions.

f) Art. 14 (2) provides that the parties may recover whatever they supplied or paid in accordance with the provisions of the applicable law. This principle is confirmed by recent legislation (Algeria art. 103 (1); Israel s. 21; Portugal art. 289 (1); USA Restatement §§ 376, 384).

However, art. 14 (2) should be redrafted for several reasons. First, one must now also take into account the possibility of part avoidance. Second, the provision should be drafted in terms of an obligation for restitution rather than in terms of a right for recovery. Third, the reference to the provisions of the "applicable law" must be replaced by an autonomous regulation; one may consider whether that should be given here or whether reference should be made to the rules which will have to be established for the return of the mutual performances upon rescission of a contract. The latter solution would seem to be the more rational solution. Proposal:

"Where a contract has been fully or partly avoided, the parties shall restore to each other what they have received under the contract insofar as it has been avoided. The provisions on restitution upon rescission of a contract shall apply accordingly."

See now art. 16.

g) In accordance with art. 14 (3), the party avoiding a contract may demand damages in some countries. Causation of the defect by the other party, but not its fault, is required for such an action in the CSSR (§§ 37, 251). Rodière (nos. 9, 18, 26) probably demands causation and fault by the other party since he refers to the general rules on delictual liability. The GDR (§ 15 (2)) limits a claim for damages to cases of fraud and threat since these are also torts.

In the light of these various national rules it should be made clear that the party entitled to avoid the contract may only demand damages if the other party has negligently caused the mistake or has committed a fraud or made a threat.

h) The relationship between damages and avoidance should be specified. Damages may be claimed either in addition to, or instead of, avoidance. Proposal:

"1. The party who is entitled to avoid the contract may, in addition to, or in lieu of, avoidance demand damages if the other party has negligently caused the mistake, has committed a fraud, made a threat or abused an unequal bargaining power."

See now art. 17.

i) As in the case of the present art. 14 (2), it is doubtful whether, in defining the claim for damages, the reference to the "applicable law" may remain. This depends upon two questions as to the scope of the planned regulation. It is assumed that this will not cover torts, so that a delictual basis of a claim for damages would not be regulated. In some countries, claims arising from the process of contracting are regarded as of a special contractual nature. Even if this qualification as such is not adopted, the intimate connection of claims for "culpa in contrahendo" with the contracting process would militate in favour of adopting appropriate rules. Although the present text of ch. 1 does not yet contain a relevant provision, one ought to consider it.

As to the rules governing the claim for damages, we shall therefore propose two alternative versions; see infra j).

j) The rule of art. 14 (4) has been confirmed in essence in the GDR (§ 15 (3)). It allows the other party a claim for reimbursement of its expenses against the mistaken party, except if the claimant knew or ought to have known the mistake. A comparable rule amounting, however, to the granting of damages in the discretion of the court, has also been adopte in Israel, see s. 14 (b) sent. 2.

As to the rules applicable to the claim for damages granted by art. 14 (4), the same questions arise as have been discussed supra sub i) for art. 14 (3); the same solution is appropriate. Therefore, the two alternative formulas as to the applicable rules will be placed together in a separate paragraph, to be inserted after present art. 14 (4).

3. First alternative: "Art. x of ch. 1 applies to the claims for damages."

Second alternative: "The claims for damages are governed by the rules of the applicable national law."

See now art. 17.

11. Art. 15 of the UNIDROIT text provides:

> " 1. If the co-contractant of the mistaken party declares himself willing to perform the contract as it was understood by the mistaken party, the contract shall be considered to have been concluded as the latter understood it. He must make such a declaration promptly after having been informed of the manner in which the mistaken party had understood the contract.
>
> 2. If such a declaration is made, the mistaken party shall thereupon lose his right to avoid the contract and any other remedy. Any declaration already made by him with a view to avoiding the contract on the ground of mistake shall be ineffective."

Several recent enactments have adopted the rule of [illegible] 15 (1): Algeria art. 85; Israel s. 14 (c); the Netherlands art. 6.5.2.12a (1); see also Portugal art. 248 for a special case of mistake.

) For good reason, these countries have placed their rovisions into the context of their rules on mistake ather than at the end of the provisions on defects of onsent. If retained, the present art. 15 should there- ore be inserted after the new version of art. 9; see ow art. 12.

) While one author wishes to retain art. 15 with the roposed amendment, the other author wishes to replace it by n alternative provision on revision of the contract cover- ng all the kinds of defective consent and unconscionability.

In the view of this author both art. 15 of the UNIDROIT ext and the amended version are too absolute and at the same ime too narrow. They are too absolute because a mistake caused y one party may disrupt the mutual confidence which in many ontracts is a necessary requirement for the functioning of he relationship. In such cases the co-contractant of the istaken party should not be entitled to uphold the contract.

They are too narrow because they only permit the person ho was not in mistake to ask for performance. The mistaken rty should also in some cases be permitted to have the con- act performed, if for instance, it can be shown that the co- ontractant has performed several similar contracts upon the rms as they were understood by the mistaken party. And such evision of the contract should also be possible in other cases defective consent and in the cases of unconscionability.

It must be conceded that in many situations it will not appropriate for a court to uphold a contract which has en made under the impact of fraud or duress or by abuse of

unequal bargaining power of one of the contracting parties. Even if the contract might be revised the behaviour of this party will have prevented or spoiled any confidence between the parties. The other author is also aware of the fact that several legal systems do not give the court the power of revising instead of avoiding a contract. However, where the contract has been performed wholly or in part, and in cases of mistake and unconscionability it may often be more reasonable and realistic to revise the contract than to avoid it. In many of these cases the avoidance of the contract will not meet the interests of the parties. This is clearly seen in the law of sales where, as provided in the present UNIDROIT text art. 9, the buyer is not entitled to avoid the contract on the ground of mistake if the circumstances on which he relied afford him a remedy based on the non-conformity of the goods with the contract. In such cases the law of sales will often give the buyer the option to uphold the contract and to claim a reduction of the price. This and other remedies should also be available in cases of duress, fraud, abuse of unequal bargaining power, and unconscionability. For example: A person having bought and built in his house crossbeams which were fraudulently represented by the seller to have come from a medieval monastry should be allowed to keep them at a reduced price. Furthermore, several of those legal systems which have introduced the doctrine of unconscionability have given the court the power of revising instead of avoiding the contract, see the Danish and Swedish Contract Act § 36, the Finnish Consumer Protection Act (2o January 1978, no. 38) Chapter 4, § 1, and the American UCC § 2.3o2. The American doctrine of mistake also allows the court to rectify the contract (see Williston, Contracts, rev. ed. s. 1544). This is also possible in English equity (see Treitel, Law of Contract, 5. ed. 1979, p. 222 ff.).

Proposal:

"1. Instead of avoidance the contract may be revised in order to bring it in accordance with what was understood by a mistaken or deceited party or to avoid any unreasonable or unconscionable result.

2. Articles 11, 13, 16, 17 and 18 also apply to claims for revision of the contract." (see art. 12 alternative)

This provision will at the request of one of the parties give the court the power to enforce the contract as it was understood by the mistaken or deceited party. Thus the court may order a seller who has fraudulently induced the buyer to purchase a gold-ingot representing it to be 24-carat whereas in fact it was 18-carat to deliver a 24-carat gold-ingot . The court will also have it in its power to enforce the contract without one or more unconscionable clauses and to revise the clauses of the contract. Thus, a borrower of money having been exposed to usury may demand a reduction of the extortionate interest and the omission of a clause in the loan contract providing for compound interest.

15. Art. 16 of the UNIDROIT text provides:

"1. The fact that the performance of the assumed obligation was impossible at the time of the conclusion of the contract shall not affect the validity of the contract, nor shall it permit its avoidance for mistake.

2. The same rule shall apply in the case of a sale of goods that do not belong to the seller."

a) This rule remains controversial. Some countries have clearly enacted the traditional provision declaring a contract void the performance of which is impossible at the time of contracting: Algeria art. 93; CSSR § 28; GDR § 12 (1); in essence also, although with certain attenuations, Portugal art. 401.

It is more difficult to offer illustrations for the contrary opinion because this is not usually expressly spelt out by legislation. However, both the Netherlands and the USA have adopted this view.

Netherlands: Hartkamp, Compendium van het Vermogensrecht volgens het Nieuwe Burgerlijk Wetboek (1977) nos. 27o, 365. USA: see Restatement § 266.

We do not see any reason to amend the main rule of art. 16 (1).

b) On art. 16 (2) the question may be asked whether this rule should not now be divorced from the background of the sale of goods, as was done with respect to art. 9. In the new context this indeed is desirable. Proposal:

"2. The same rule shall apply if the assets to which the contract relates are not held by the person disposing of them. "

See now art. 19.

16. The UNIDROIT text does not deal with the confirmation of a voidable transaction.

a) By contrast, almost all recent legislation contains a provision excluding avoidance if the party entitled to avoid has confirmed the voidable transaction. It is usually required that such confirmation is only effective after the term for giving notice of avoidance has started to run (see present art. 12 (2) - (3)).

Algeria art. 1oo; CSSR § 31 (2); GDR § 14 (1) sent. 2 (for mistake); the Netherlands art. 3.2.18 (1); Portugal art. 288; USA Restatement § 58o.

It is therefore proposed to insert a corresponding provision into the draft.

Proposal:

"Avoidance of a contract is excluded if the party who is entitled to avoid the contract after the term for giving notice of avoidance has commenced to run (art. 12 (2)) expressly or impliedly confirms the contract."

b) One of the authors has proposed to omit terms for giving notice (see supra no. 11 sub b). He must therefore use an alternative version:

"Avoidance of a contract is excluded if the party who is entitled to avoid the contract expressly or impliedly confirms it. Such confirmation is only relevant if it is given

a) in the case of mistake, fraud or unconscionability, after the confirming party knew of it;

b) in the case of threat or abuse of unequal bargaining power, after the confirming party became capable of acting freely."

c) Dutch law goes one step further. It empowers any person immediately concerned to demand from the person entitled to avoid the contract a declaration within a reasonable time whether he intends to avoid or to confirm the contract. If no reply comes forth within the term set, avoidance is excluded (art. 3.2.18 (2)).

The person most immediately concerned will be the other contracting party. We do not regard it as appropriate to give this party such a sharp weapon against the mistaken, defrauded or threatened party. Therefore we do not recommend a provision on the Dutch pattern.

d) The proposed rule on confirmation should be inserted before the provisions on the procedure of avoidance, i.e. before present art. 12. See now art. 11.

17. Taking up the idea of art. 2 (2) of the UNIDROIT text (see supra no. 2 sub b) we propose a rule on the mandatory character of the provisions of this chapter.

a) Which of the provisions should be made mandatory? It is easier to start from the opposite end and to ask which of the provisions need not be declared to be mandatory.

(1) Clearly art. 16 of the UNIDROIT text on initial impossibility should not be mandatory. The parties should be able to condition the validity of their contract on the initial possibility of its performance.

(2) More doubtful is the case of mistake. The draft itself indicates a solution since art. 6 lett. b) declares relevant the assumption of the risk of mistake by the mistaken party.

Some laws restrict the possibility of excluding the risk or the liability for a mistake which was caused by the other party's negligent misrepresentation, see for instanc

the English Misrepresentation Act 1967, s. 3 as amended by the Unfair Contract Terms Act 1977, s. 8. This idea should be followed because the contractual assumption of the risk of mistake is certainly not designed to cover cases where the mistake has been negligently caused by the co-contractant of the mistaken party.

b) It would seem that all other provisions of this chapter (including those on the procedure of avoidance, except insofar as they apply to mistakes) should be mandatory.

c) Proposal:

" 1. The rules of this chapter are mandatory, except insofar as they relate or apply to mistake and to initial impossibility.

2. A contractual term by which a mistaken party assumes the risk of mistake does not apply to a mistake which has been caused by the other party's negligence."

See art. 18.

The proposed text

Chapter 3: Validity of Contracts

Art. 1 Definition of mistake

Mistake is an error relating to facts or to law existing when the contract was concluded.

Art. 2 Mistake

A party may only avoid a contract for mistake if the following conditions are fulfilled at the time of the conclusion of the contract:

(a) the mistake is, in accordance with the principles of interpretation, of such importance that the contract would not have been concluded on the same terms if the truth had been known; and

(b) the mistake does not relate to a matter in regard to which the risk of mistake was expressly or, in all the relevant circumstances, impliedly assumed by the party claiming avoidance; and

(c) the other party has made the same mistake, or has caused the mistake, or knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error.

Art. 3 Error in transmission

A mistake in the expression or transmission of a statement of intention shall be considered as the mistake of him from whom the statement emanated.

[Art. 4 Breach remedies preferred

A party shall not be entitled to avoid the contract on the ground of mistake if the circumstances on which he relies afford, or could have afforded, him a remedy for breach of contract.]

Art. 5 Fraud

1. A party who was induced to conclude a contract by a mistake which was caused by the other party's fraudulent misrepresentation may avoid the contract. The same applies if the mistake was caused by the other party's fraudulent non-disclosure of circumstances which in the situation he was obliged to disclose.

2. Where fraud is imputable to a third party for whose acts the other contracting party is not responsible, the contract may be avoided for fraud if the other contracting party knew or ought to have known of the fraud.

Art. 6 Threat

A party may avoid the contract when he has been led to conclude it by an unjustifiable threat which [,in his judgment,] is so imminent and serious as to leave him no reasonable alternative. In particular, a threat is unjustified if the act or omission with which the promisor has been threatened is unlawful in itself or, although lawful, it is unlawful to use it as a means to obtain the promise.

Art. 7 Unequal bargaining power

A party may avoid a contract when the other party has taken advantage of his dependence, economic distress or urgent needs, or of his improvidence, ignorance, inexperience, or lack of bargaining skill, to obtain terms which make the contract as a whole unreasonably advantageous for the other party and unreasonably disadvantageous for him.

Art. 8 Unconscionability

A party may avoid or have revised a contract if at the time of the making of the contract there are an unconscionable disparity between the obligations of the parties or other unconscionable contract clauses which grossly upset the contractual equilibrium.

Art. 9 Initial impossibility

1. The fact that the performance of the assumed obligation was impossible at the time of the conclusion of the contract shall not affect the validity of the contract, nor shall it permit its avoidance for mistake.

2. The same rule shall apply if the assets to which the contract relates are not held by the person disposing of them.

Art. lo. Agents

Where a fraud, a threat, an abuse of unequal bargaining power or a party's mistake is imputable to, or is known or ought to be known by, an agent of the other party, the contract may be avoided under the same conditions as if it had been concluded by the other party himself.

Art. 11 Confirmation

Avoidance of a contract is excluded if the party who is entitled to avoid the contract after the term for giving notice of avoidance has commenced to run (art. 13 (2)) expressly or impliedly confirms the contract.

Alternative art. 11

Avoidance of a contract is excluded if the party who is entitled to avoid the contract expressly or impliedly confirms it. Such confirmation is only relevant if it is given

(a) in the case of mistake, fraud or unconscionability, after the confirming party knew of it;

(b) in the case of threat or abuse of unequal bargaining power, after the confirming party became capable of acting freely.

Art. 12 Counter offer

1. If the co-contractant of the mistaken party declares himself willing to perform the contract as it was understood by the mistaken party, the contract shall be considered to have been concluded as the latter understood it. He must make such a declaration promptly after having been informed of the manner in which the mistaken party had understood the contract.

2. If such a declaration is made, the mistaken party shall thereupon lose his right to avoid the contract and any other remedy. Any declaration already made by him with a view to avoiding the contract on the ground of mistake shall be ineffective.

Alternative art. 12 Revision of the contract

1. Instead of avoidance the contract may be revised in order to bring it in accordance with what was understood by a mistaken or deceited party or to avoid any unreasonable or unconscionable result.

2. Articles 11, 13, 16, 17 and 18 also apply to claims for revision of the contract.

Art. 13 Avoidance

1. Avoidance of a contract must be by express notice to the other party.

2. The notice must be given within a reasonable time, with due regard to the circumstances

(a) in the case of mistake, fraud or unconscionability, after the avoiding party knew of it;

(b) in the case of threat or abuse of unequal bargaining power, after the avoiding party has become capable of acting freely.

Alternative art. 13

In case of mistake and unconscionability and in the cases of fraud, threat or abuse of unequal bargaining power not exercised by, and unknown to, the other party avoidance of the contract must be given by notice to the other party within reasonable time.

[Art. 14 Time limit

1. In case of mistake, any notice of avoidance shall only be effective if it reaches the other party within reasonable time.

2. In any event, the notice shall only be effective if it reaches the other party within two years after the conclusion of the contract in the case of mistake or within five years after the conclusion of the contract in the other cases.]

Art. 15 Retroactive effect of avoidance

1. If the other party does not object to the notice of avoidance or if it is otherwise established that the avoidance is effective, the contract is avoided retroactively, subject to any rights of third parties.

2. If the ground of avoidance affects only part of a severable contract, avoidance is limited to this part of the contract if, giving due consideration to all circumstances of the case, it is reasonable to uphold the contract.

Art. 16 Restitution

Where a contract has been fully or partly avoided, the parties shall restore to each other what they have received under the contract insofar as it has been avoided. The provisions on restitution upon rescission of a contract shall apply accordingly.

Art. 17 Damages

1. The party who is entitled to avoid the contract may, in addition to, or in lieu of, avoidance demand damages if the other party has negligently caused the mistake, has committed a fraud, made a threat or abused an unequal bargaining power.

2. If a mistake was at least in part the fault of the mistaken party, the other party may obtain damages from the party who has avoided the contract. In determining damages, the court shall give due consideration to all relevant circumstances, including the conduct of each party leading to the mistake.

3. First alternative

Art. x of ch. 1 applies to the claims for damages.

Second alternative:

The claims for damages are governed by the rules of the applicable national law.

Art. 18 Mandatory character of the rules

1. The rules of this chapter are mandatory, except insofar as they relate or apply to mistake and to initial impossibility.

2. A contractual term by which a mistaken party assumes the risk of mistake does not apply to a mistake which has been caused by the other party's negligence.