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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

STUDY GROUP ON THE

PROGRESSIVE CODIFICATION OF INTERNATIONAL TRADE LAW

R E P O R T

on the 2<sup>nd</sup> Session of the Study Group

held in Rome from 5 to 9 April 1982

(prepared by the Secretariat of UNIDROIT)

Rome, June 1982

1. The Study Group on the progressive codification of international trade law met for its second session at the headquarters of the Institute from 5 to 9 April 1982. The list of participants is attached hereto (ANNEX).

2. In opening the session, the President of UNIDROIT, Mr Mario MATTEUCCI, first informed the members of the Group that Professor René DAVID had announced his intention no longer to act as Chairman. While expressing his regret at this decision, which was entirely due to personal reasons, and stressing the hope that Professor DAVID might nevertheless be able to assist the Group at its future sessions, he asked Professor Tudor POPESCU to take the chair, not only on account of his outstanding competence in the field of international trade law, but also in consideration of the fact that, as a member of the Governing Council of UNIDROIT, he could ensure the desirable link between the Study Group and the Governing Council.

The President then briefly recalled the progress which has been made in the preparation of the next chapters of the proposed Code since the first session of the Study Group in September 1979. From among the members of the Group who had on that occasion declared their willingness to cooperate actively with the Secretariat of UNIDROIT in this project an informal Working Group had been set up which had met on two occasions, in Copenhagen (1980) and in Hamburg (1981). The Copenhagen meeting was essentially of an exploratory character, while in Hamburg the Group examined two preliminary drafts relating to Chapter III on validity of international contracts in general. The first, elaborated by Professor DROBNIG (Hamburg) and Professor LANDO (Copenhagen) aimed at the revision of the existing UNIDROIT draft of a law for the unification of certain rules relating to validity of contracts of international sale of goods of 1972, so as to adapt it to the requirements of international commercial contracts in general, while the second, prepared by Professor MASKOW and Dr ANDRAE (Potsdam-Baldersberg) dealt with the problem of illegality of international commercial contracts. As to the first draft, the Working Group unanimously felt that it represented a considerable improvement over the 1972 UNIDROIT draft, not only because a number of new provisions had been added in order to cover important questions such as the abuse of unequal bargaining power, gross unfairness and the right of adaptation, but also on account of the fact that the remaining part of the draft had been revised in the light of recent developments in international legislation and case-law. With respect to the draft rules prepared by Professor Maskow, the other members of the Group agreed that,

notwithstanding the extreme complexity of the various problems which arise in connection with public prohibitions and permission requirements relating to international contracts, and the fact that this was the first attempt to deal with them in a general and systematic manner at international level, the draft already provided an extremely useful basis for discussion.

After the Hamburg meeting, both drafts were revised so as to take into account the various observations and proposals for amendment which had been made on that occasion. In their present version, on which the Study Group was called upon to express its views, they might therefore be considered as the product of the Working Group as a whole.

In concluding his introductory remarks the President expressed to Professors Dröbnig, Lando and Maskow the deep appreciation of UNIDROIT for the most valuable assistance they had given it in carrying out this difficult project. He also thanked all the other members of the Study Group for having accepted the invitation to attend the meeting and stressed the great satisfaction of the Institute at having been able to associate such a large number of highly qualified specialists in the field of comparative and private international law in the work on the progressive codification of international trade law.

3. Professor POPESCU thanked the President of UNIDROIT as well as the members of the Study Group for the confidence they had placed in him by asking him to take the chair. After pointing out that he considered it to be a great honour to succeed in this post to such an eminent figure as Professor David, he expressed the hope that in carrying out his functions he would receive assistance from all the other members of the Group, and in particular from Professor SCHMITTHOFF who, not only had from the very beginning actively cooperated in the codification project in his capacity of a member of the Steering Committee, but whose outstanding competence and experience in the field of international trade law would also in the future offer a guarantee for the successful work of the Group as a whole.

4. The Chairman then opened the discussion on the first part of the Draft Rules on the substantive validity of international contracts, that is to say those concerning Mistake, Fraud, Threat, Unequal Bargaining Power and Gross Unfairness, which were intended to constitute Section 1 of Chapter III of the Code (cf. UNIDROIT 1982 - Study L - Doc. 20).

5. Only a few remarks were made with respect to Article 1 ("Definition of mistake"). One concerned the use, in the English version, of the term "mistake" which, at least according to English domestic law, traditionally bore a very restricted meaning. It should therefore be replaced by the more neutral term "error", so as to make it clear that the scope of Articles 1 and 2 of the draft was a much wider one, in that it included also cases of fraudulent misrepresentation. In rejecting this proposal it was pointed out that it is almost unavoidable that some concepts used in the English or French texts of the draft would have in the respective national legal systems a meaning different from that given to them in the framework of the uniform rules and that in order to avoid possible misunderstanding it should be sufficient to recall the necessity of interpreting the present rules in an autonomous way in the same manner as any other legal text elaborated at an international level.

Another point which was raised concerned the fact that according to the present definition of mistake in Article 1 a simple mistake in motive might also be relevant -- a result which could hardly be accepted, particularly if it was recalled that the proposed rules were intended to apply to international trade relationships where a party may very well have been led to the conclusion of a single transaction by incorrect market expectations without therefore being entitled to avoid the contract. In this respect, attention was however drawn to the fact that the conditions under which one party may avoid a contract on the ground of mistake are stated in Article 2, and that it follows from the requirements laid down in sub-paragraphs (a) and (c) thereof that a simple mistake in motive of one party is normally to be considered as irrelevant for the fate of the contract.

6. As to Article 2 ("Mistake"), the discussion was first concentrated on the provision contained in sub-paragraph (a). In this connection it was pointed out that simply stating "in accordance with the principles of interpretation", does not make it clear what kind of principles are actually meant. If, as stated in the explanatory report, the intention was to refer to the rules and criteria contained in Chapter II of the Code, such a reference should be made expressly in the text. It was further argued that whereas in the explanatory report it was very clearly stated that in order to be relevant the mistake must relate to very important or essential matters, this idea was not sufficiently reflected in the text, the formulation of which appeared to be rather subjective or at least too vague. It was therefore suggested either to insert in the present text before the word "terms" the word "material" or to redraft the whole provision so as to

read "(a) the mistake is of such importance that a reasonable man in the same external circumstances as the errans would have contracted only on materially different terms or would not have contracted at all if the true state of affairs had been known ..."

Turning to sub-paragraph (b), the view was expressed that it was not sufficient to refer only to cases where the risk of mistake was expressly or impliedly assumed by the errans: indeed a party may be prevented from claiming avoidance not only where he has more or less voluntarily or consciously assumed a possible risk on his side, but also where it follows from the circumstances (e.g. the nature of the contract; the normal course of dealing within the respective trade sector; etc.) that the risk is to be allocated to that particular party, whether he is aware of this or not. Moreover, since both sub-paragraphs (a) and (c) lay down positive requirements for the relevance of mistake whereas sub-paragraph (b) refers to a negative condition, it was suggested placing it in a separate paragraph which in the light of the above-mentioned remarks could read as follows: "However, a party may not avoid the contract, if the mistake relates to a matter in regard to which the risk of mistake was assumed or, taking into account all the relevant circumstances, should be borne by the mistaken party".

With respect to the provision contained in sub-paragraph (c) according to one view it should be made clear that it refers only to a "common mistake" and not to a "mutual mistake". This could be achieved by adding to Article 2 a new provision which expressly states that if the parties assume that they have contracted but they have in fact not contracted there shall be no contract. In this connection, it was however pointed out that the proper place for such a provision, assuming it were really needed, was not Chapter III (Validity of Contracts), but Chapter I (Formation of Contracts). According to another view, it would be going too far to give the mistaken party the right to avoid the contract not only when the other party had made the same mistake or had caused it or knew of it, but also if he merely "ought to have known" of it. Indeed, apart from the difficulties of proving which kind of mistake the innocent party should in a given case have been aware of, the result would in any event be to give too much wide relevance to mistakes in international trade practice.

Considerable support was finally given to the proposal to introduce a new paragraph stating that if a mistake is due to the fault of the mistaken party, it shall not prevent that party avoiding

the contract unless it amounts to gross negligence. At the same time however, the opinion was expressed that, once the provision contained in sub-paragraph (b) was changed along the lines previously suggested, it might already follow from that provision that in the case of gross negligence the mistaken party had to run the risk of his mistake.

7. With respect to Article 3 ("Mistake in expression or transmission") several members of the Group expressed the view that the case of a mistake in the transmission of a statement is entirely different from that of a mistake in the declaration and should therefore be dealt with differently. More precisely, whenever a message sent by one party to the other reaches the latter in a distorted form because of its defective transmission by the particular telecommunication system which had been chosen, this falls outside the law on mistake and should be solved according to the rules on the formation of contracts. Accordingly, in some cases there will be no contractual agreement at all, while in others the contract will have to be considered as validly concluded and the sender of the message should bear the risk of its wrong transmission, without of course being prevented from claiming compensation from the competent post or telegraph office. In this respect, it was however pointed out that the solution adopted in the draft is based on the assumption that the transmitter of the message (who by the way is not necessarily a post office, but may very well be an employee of the sender) is to be considered as acting as a kind of agent or prolonged arm of the sender, so that it is only logical to treat the mistake on his part in the same way as if it was made by the sender himself. After all, in this way not every mistake in transmission, but only those which meet the conditions laid down in Article 2 will become relevant in practice.

8. As to Article 4 ("Breach remedies preferred") a proposal was made to delete the provision altogether. According to the majority of the Group it was however preferable to defer any final decision on it until such time as the rules on the conditions of rescission for breach of contracts had been elaborated in detail.

9. Turning to Article 5 ("Fraud"), several members of the Group expressed their reservations as to the link which this provision established between the concept of "fraud" and that of "mistake". It was pointed out that under most of the existing legal systems fraud covers a much wider area than that of causing a mistake. Indeed, a party who has been induced to conclude the contract by any kind of "manoeuvres dolosives" on the part of

the co-contractant may normally avoid the contract even in the absence of a mistake stricto sensu on his part. Other speakers drew attention in this respect to the explanatory report where it is very clearly stated that the fraudulently caused mistake referred to in the present article has nothing in common with the "simple" mistake of Article 2. In order to avoid possible misunderstanding it was however agreed to delete in the present article any reference to mistake and to redraft the provision in the following way: "A party may avoid the contract when he has been led to conclude it by the other party's fraudulent misrepresentation or fraudulent non-disclosure of circumstances which according to reasonable commercial standards of fair dealing he should have disclosed".

10. With respect to Article 6 ("Threat") it was suggested restricting the relevance of a threat emanating from third persons to those cases where the other contracting party knew or at least ought to have known of it. In this connection it was however pointed out that a party's interest in being able to enter into a contract freely deserves absolute and unqualified protection, irrespective of whether or not the threat emanated from the co-contractant himself or from a third person. After all, at least in international trade practice it is very unlikely that a third person will intervene in such a reprehensible manner entirely on his own initiative and not because of the existence of common interests with the co-contractant. As to the condition that a threat must be "so imminent and serious" as to leave the party "no reasonable alternative", there was general agreement that it should not be understood as including the relevance of "economic threats" (e.g. cases where a party, after having been granted an "on demand" guarantee, declares his intention to take up such a guarantee unless the other party agrees to extend his contractual obligations or otherwise to modify the original agreement to his own detriment). Finally, it was decided, in the second line of the provision, to replace the word "unjustifiable" by "unjustified", and to adopt, in the last but one and last line, the expression "unlawful" instead of "improper".

11. A particularly lengthy discussion took place with respect to Articles 7 ("Unequal bargaining power") and 8 ("Gross unfairness").

It was pointed out from the very beginning that the two provisions are closely linked, since both envisage a situation where the content of a given contract is clearly one-sided, i.e. manifestly advantageous for

one party and correspondingly disadvantageous for the other. However, while under Article 7 this objective condition is not sufficient and for the avoidance of the contract it is necessary that one party has taken advantage of the dependence, economic distress or urgent needs or of the improvidence or lack of bargaining skill of the other party, under Article 8 no such additional subjective text is required, it being sufficient that the disequilibrium between the obligations of the parties is "grossly unfair", i.e. is of such an extent as to shock per se the conscience of the court.

The Group turned out to be equally divided between those who supported the approach adopted by the draft and those who suggested combining the two provisions in a single article.

Those who were in favour of the present solution drew attention to the fact that in practice a contract may very well prove to be "grossly unfair" as a whole or in some of its individual clauses, even without there having been any real exploitation by one party of a situation of weakness of the other. Such contracts also should be avoidable and for that reason a separate provision of the kind contained in Article 8 was thought to be needed, as was demonstrated by the large number of recent national legislations which have provided for a similar situation.

In rejecting this view the other members of the Group first of all pointed out that most of the national provisions which had been quoted are restricted as regards their field of application to contracts concluded on the basis of general conditions or standard forms. What was however even more decisive was that the underlying idea or philosophy of Article 8 seemed to be entirely inconsistent with the rest of the draft. Indeed, all the other provisions contained therein referred to cases where, because of the behaviour of one party, the other was induced to conclude the contract in terms different from those which would otherwise have been accepted by him and was therefore entitled to avoid the contract, whereas what was decisive for the purpose of Article 8 was not the behaviour of one of the parties but the content of the contract as such, so that the proper sanction should be the nullity of the contract to be declared by the judge, rather than the possibility of its avoidance on the initiative of the "innocent" party.

The same members then submitted a formal proposal for combining the present Articles 7 and 8 as a new provision which would read as follows:



"(1) A party may avoid a contract when the other party has taken unfair 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.

(2) It will be presumed that unfair advantage has been taken if at the time of the making of the contract there is a grossly unfair disparity between the obligations of the parties or there are unfair contract clauses which grossly upset the contractual equilibrium. (3) In determining whether a contract or any clause thereof is avoidable under this article regard should be paid to the commercial setting and the purpose of the contract." The purpose of this proposal was to make it clear that, in order to be avoidable, an unfair contract must be the result of the advantage which one party has taken of the dependence, economic distress or urgent needs, or simply of the inexperience or lack of bargaining power of the other party, but at the same time to permit the presumption that such an unfair advantage has been taken whenever there is a grossly unfair disparity between the obligations of the parties or there are unfair contract clauses which grossly upset the contractual equilibrium.

The rest of the Group was however unable to accept this proposal. It was pointed out that the new provision, instead of representing a combination of the present Articles 7 and 8, rather turned out to be a redraft of Article 7 only. According to another view there appeared to be an inconsistency between paragraph 1 and paragraph 2, insofar as the presumption laid down in paragraph 2 was based on criteria different from those adopted in the last part of paragraph 2 and which specified what has to be presumed. Finally, the question was raised as to how the stronger party could ever be able to rebut the presumption of paragraph 2, if to this end he must furnish proof of something which only the other party would be in a position to evaluate, namely the absence of any sort of exploitation of his weakness.

It was therefore decided to set up a small drafting committee with the task of finding a compromise solution. The new proposal submitted by the committee read as follows: "A party may avoid a contract if at the time of the making of the contract there is a gross disparity between the obligations of the parties or there are contract clauses grossly upsetting the contractual equilibrium, provided that they are unjustifiable having regard to, among other things, (a) the fact that the other party has taken unfair advantage of his dependence, economic

distress or urgent needs, or of his improvidence, ignorance, inexperience or lack of bargaining skill, or (b) the commercial setting and the purpose of the contract".

According to one view the reference to the time of the conclusion of the contract ought to be deleted, since there might be contractual terms which turned out to be unfair only at a later stage, when it became clear that due to circumstances occurring after the conclusion of the contract their application would in practice lead to an entirely unacceptable result. In this respect it was however pointed out that the proper place for dealing with such a situation would be the chapters on hardship and non-performance, whereas the present provision, to be found in the chapter on validity, ought to be confined to cases where the unfair character of a contractual term was apparent per se, right from the time of the conclusion of the contract. Furthermore, the precise meaning of the word "dependence" was questioned. According to some members it should also cover the so-called market-dependence, i.e. the situation where one of the parties has taken unfair advantage of his monopoly or absolutely predominant market position in the respective trade sector. The majority of the Group was however against such a broad interpretation of the word "dependence", which could lead to the result that in practice, even if there were no gross disparity between the obligations of the parties nor a contract clause which grossly upset the contractual equilibrium, the economically weaker party might seek to avoid the contract simply because the other party occupied a predominant market position. The only kind of "dependence" envisaged by the present provision was that deriving from a particular legal or financial relationship (e.g. mother company - single affiliates; banking institution - client; etc.) which exists between the two parties concerned.

With these reservations and clarifications the Group finally agreed on the new text of Article 7 which is intended to replace the former Articles 7 and 8.

12. Different views were also expressed as to Article 9 ("Initial impossibility"). According to one view the provision contained in the first paragraph should be deleted as a whole, since it was not only contrary to a number of national laws, but could also give rise to considerable difficulties in practice, especially if it were intended to apply also to cases of legal impossibility. Other members however not only strongly supported the basic idea of both paragraph 1 and 2, but suggested going even further by deleting in the last sentence of the two paragraphs any specific reference to mistake, so as to make it clear that the fact that at the time of the conclusion of the contract the performance of the

assumed obligation was impossible or that a party was not entitled to dispose of the assets to which the contract related should not permit the avoidance of the contract for any reason whatsoever. A third solution which was proposed was to delete the last sentence of the two paragraphs altogether, since it was felt that whenever in cases of initial impossibility or of lack of title in practice the conditions laid down in the previous articles of the draft for the avoidance of the contract on the ground of mistake or the other defects in consent were fulfilled, the possibility of relying also on such a remedy should not be excluded by the present provision. Although there were some reservations as to the logical coherence and the practical implications of such a solution, the Group eventually decided to accept this proposal.

13. With respect to Article 10 ("Third persons"), it was first of all decided to replace in the first paragraph the words "a person acting for the other party" by the words "a third party for whose acts the other party is responsible" so as to use a formula corresponding to that already adopted in paragraph 2. After all, it was argued, this would help to make it clear that a "commission agent" or a broker who, although acting in the interest of one of the parties, certainly cannot be considered as a person for whose acts the same party is to be held responsible, belongs to the "third persons" referred to in paragraph 2 and not to those of paragraph 1. Doubts were then expressed as to the solution to be adopted in the far from rare cases in current international trade practice where one party succeeds in concluding the contract because of the intervention of an intermediary who offered a bribe to the other party. In this respect the general view was that in these cases the question which arises is normally not so much one of avoiding the contract on the ground of a defect in consent, but rather one of declaring the contract null and void because of the non-observance of legal rules which expressly prohibit such immoral practices. Finally, several members of the Group again raised the question of the threat emanating from a third person and insisted on the necessity of applying also to this case the general rule laid down in Article 10, so that the contract would be avoidable only if the other party either was responsible for the acts of the third person or knew or ought to have known of the threat. As however had already been the case when the same problem had been discussed in connection with Article 6, the proposal did not enjoy the support of the majority of the Group.

14. Whereas Article 11 ("Confirmation") was considered to be entirely satisfactory, it was with respect to Article 12 ("Counter offer") decided first of all to change the present title so as to reflect more properly the

content of the provision to be found in the article. Following the example of Art. 1432 of the Italian Civil Code the suggestion was made to speak of "Maintenance of a rectified contract". It was further suggested not to limit the scope of the provision to cases of mistake, but to extend it also to cases of gross unfairness. In this regard it was however pointed out that a party responsible for the grossly unfair content of the contract should not be enabled to prevent the innocent party avoiding the contract by taking the initiative unilaterally to "rectify" the contract. If the parties had a legitimate interest in maintaining the contract the proper "remedy" would be to ask a court or an arbitrator to adapt it, as was already provided for by Article 13.

15. As to Article 13 ("Adaptation of the contract") some members were of the opinion that the revision or adaptation of a contract should only be possible on the basis of a renegotiation between the parties themselves and not as a result of an intervention of a court or an arbitrator. After all since in several national legal systems judges traditionally do not have the power to take a decision of this kind, it was doubtful whether the proposed rule could ever become effective in practice. In this respect it was however pointed out that nothing in the present article prevented the parties from first attempting to reach an agreement between themselves on the new terms of the contract, recourse to a court or an arbitrator clearly being intended as a last resort. Not only, but instead of going before a State tribunal or of submitting the case to arbitration in the traditional sense, the parties could of course also entrust a conciliator or any other independent person with the task of adapting their contract. Such a possibility already existed under the present draft, since Article 13 was of a non-mandatory character (cf. Article 20). It was however decided to render it even clearer by inserting after the words "the court or arbitrator" the words "or conciliator or any other third person".

Even those who were very much in favour of the basic idea underlying Article 13 raised several objections as to its present formulation. First of all, it was decided, though only by a small majority, to delete any reference to cases of mistake, and therefore to restrict the possibility of adaptation under Article 13 to the case where the contract is avoidable for gross unfairness. Furthermore, the question was raised as to whether there was not an inconsistency in providing that a party may request the adaptation of the contract only if its avoidance could lead to his suffering undue hardship. Indeed, since this condition could be understood as if there should already have been a declaration of avoidance

on the side of the other party, one might object that a contract, once it has been avoided, is no longer capable of adaptation. In order to avoid any misunderstanding on this point, it was decided to add a new paragraph containing a provision similar to that already to be found in paragraph 2 of Article 12. Finally several speakers pointed out that the precise procedure to be followed in the process of adaptation was not yet sufficiently clear. However, since the problem of a third person's intervention for the adaptation of the contract would have to be dealt with again in the future chapter of the Code relating to hardship, it was felt preferable not to embark for the time being on a detailed discussion of those issues and thus to postpone any decision as to the final version of Article 13 until the corresponding provisions on hardship had been elaborated. It was therefore decided to put the entire text of Article 13 between square brackets.

16. With respect to Article 14 ("Notice of avoidance"), the first question raised was whether it should not be expressly stated that only a "justified" notice of avoidance produces the result of the avoidance of the contract. The general opinion however was that this was not necessary, since it goes without saying that, whenever the party against whom avoidance is sought objects, and the court or arbitrator, who will then have to take the final decision, held that there are no legitimate reasons for avoiding the contract, the notice of avoidance previously given by the other party will lose its effect. Another proposal made in this context was to add to the present text a new provision according to which the party against whom avoidance is sought must, if he wishes so, object within a certain time-limit (e.g. two months). In this respect it was however pointed out that the duty to reply as soon as possible to a notice of avoidance already followed from the general principle of good faith and fair dealing, whereas by laying down a rule of the kind suggested one could not exclude the risk that in practice one party might abuse it, e.g. by giving notice of avoidance to the other party without any good reason, in the hope that the latter, just because of the fact that such a demand was completely unfounded, would not object to it within the fixed period of time.

Furthermore, the view was expressed that the notice of avoidance should take effect from the moment it has been dispatched and not only when it reaches the other party. According to the majority of the Group, however, it would not be a fair solution to allocate the risk in the transmission of the notice to the addressee, since, contrary to the case of rescission for non-performance, in the case of avoidance for defects in

consent the party against whom avoidance is sought has a legitimate interest in being informed that this is the intention of the other party and he should therefore be permitted to consider the contract valid, until he actually receives the notice of avoidance.

Finally, a proposal was made to add to the present text of Article 14 a new paragraph stating that "where a party seeking to avoid a contract has been notified that rights of the other contracting party have been ceded to a third party, express notice of avoidance must also be given to that party". While fully recognising the merits of such a proposal, the majority of the Group was however of the opinion that it could hardly be accepted. It was pointed out that Article 14 was not the only place where the question of the rights of third parties may arise, and that it was therefore preferable to deal with that question not on each single occasion but in a general and comprehensive way within a future chapter of the Code specifically devoted to it.

17. As to Article 15 ("Time Limits") it was decided to delete paragraph 2, since the limitation periods for the avoidance of the contract laid down therein not only could, at least in some cases, prove to be too severe for the innocent party, but could in any case meet with strong opposition in several parts of the world and in particular among the developing countries.

18. Article 16 ("Partial avoidance") in itself did not give rise to substantial objections. It was only suggested redrafting the provision so as to make it clear that what is decisive for the purpose of its application is not so much the severable character of a contract in an objective sense, but the fact that the parties considered the various obligations deriving from their agreement as severable, i.e. independent of each other.

In the context of this article, the question was raised whether in addition to partial avoidance of severable contracts one should not also envisage the possibility of invalidating individual clauses or terms of an unseverable contract. After a lengthy discussion, in the course of which it was pointed out that such a possibility, expressly admitted in a number of national legislations, was particularly important in international trade practice where it frequently happens that the parties prefer not to have the whole contract avoided but only some of its terms cancelled, the Group agreed in principle to introduce a corresponding provision in the draft. Opinions were however divided as to how the

question of partial invalidity should be best approached. According to one view the power to invalidate a single contractual term can only be given to a judge or an arbitrator, and it was therefore suggested either to follow the same approach as that already adopted by Article 13 with respect to adaptation, or to lay down a separate rule of the kind to be found in Article 6 of the draft Section 2 of Chapter III ("Prohibitions and permission requirements concerning individual terms of the contract"). According to another view the right to avoid not only the contract as a whole, but merely one or more of its individual terms, should be left to the parties and, consequently, the intervention of a judge or an arbitrator should be confined to those cases where, after one party has given notice to this end to the other, a dispute arises. The majority of the Group eventually favoured this second approach, and it was decided to include in Article 16 a new paragraph dealing with the avoidance of individual terms of an unseverable contract in accordance with the principles already adopted in paragraph 1 with respect to the partial avoidance of severable contracts.

19. With respect to Article 17 ("Retroactive effect of avoidance") according to one view the mere statement that the retroactive effect of avoidance does not affect the rights which third parties may have acquired leaves open a number of delicate questions. In order to eliminate some of the difficulties, it was suggested stating expressly, first of all, that "The rights of third parties to immovable or movable property resulting from transfer of contractual rights shall be determined by national law, subject to the proviso that (a) if a third party had acquired rights in good faith before notice of avoidance had been received by a party to the contract his rights shall be unaffected by that notice; (b) if a third party acquired rights after a party to the contract had received notice of avoidance these rights shall only be protected to the extent that his cedent's rights are protected." In addition a further paragraph should be included according to which "a third party to whom a contracting party has transferred rights may be subrogated to the latter's rights and often adjustment of contract under Article 12 or adaptation under Article 13". While fully recognising both the extreme importance of the problems raised and the merits of proposals made for their solution, the majority of the Group however again expressed the opinion that these and other questions relating to third party rights should more properly be dealt with in a separate chapter of the Code.

20. Only a brief discussion took place on Articles 18 ("Restitution") and 19 ("Damages"). Although it was unanimously felt that the questions envisaged therein were of the greatest importance, it was decided to delete

the two provisions. It was pointed out that the problem of both restitution and damages will arise also in connexion with the rescission of contracts for non-performance, and that it would therefore be preferable to deal with them in a more general and exhaustive manner in a separate chapter of the Code, specifically devoted to them. At the same time it was however decided to include in the present draft, either in Article 17 or in a separate provision, a saving clause by which it should be stated that in case of avoidance parties are bound to restore to each other what they have received under the contract and may demand damages in accordance with the rules laid down in the chapter on restitution and damages in general.

21. With respect to Article 20 ("Mandatory character of the provisions") there was general agreement as to the substance of the principle laid down in paragraph. 1. It was only questioned whether, instead of referring expressly to the provision which the parties may derogate from it was not more appropriate to provide a list of the provisions which are to be considered of a mandatory character. In this respect, however, attention was drawn to the fact that the drafting of such a list would be rather difficult, since even the articles on fraud, threat and gross unfairness were of a mandatory character only as to their substantive provisions, relating to the ground of avoidance, but not as to their rules of procedure (e.g. the period of time within which notice of avoidance has to be given, etc.). Furthermore, it was pointed out that the real purpose of Article 20 was to make it clear that in some cases the provisions laid down in the draft are to be considered as a minimum standard for the protection of the innocent party, so that the application of other provisions which grant to that party an even stronger protection should not be excluded. According to one view all these difficulties could be overcome by stating in the present article that the possibility of avoidance of the contract for such and such cases may not be excluded or limited in advance by the parties.

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22. The Group then proceeded to an examination of the second part of the Draft Rules on the Substantive Validity of International Contracts, that is to say those concerning Public Prohibitions and Permission Requirements which were intended to constitute Section 2 of Chapter III of the Code (cf. UNIDROIT 1982 - Study L - Doc. 21).

23. Before embarking on the discussion of the individual articles, some members, while fully appreciating the efforts made by the draftsmen in elaborating for the first time uniform rules on the extremely difficult and delicate problem of the effects of public prohibitions and permission requirements on international commercial contracts, expressed the view that it would be preferable for the proposed Code not to deal with such questions at all. It was pointed out that it was hardly in the interest of international trade to increase the number of cases where the validity of a given contract may be affected because of restrictions or other unilateral interventions by national authorities. The future Code should rather be based on the opposite principle of the favor validitatis, i.e. it should as much as possible favour the validity of a contract between the parties and restrict the relevance of public prohibitions or permission requirements to those cases where they constitute an impediment to the performance of the contractual obligations. In rejecting this view the majority of the Group first of all pointed out that the present draft was not intended to introduce additional grounds for the invalidity of international trade contracts, but was simply aimed at unifying the rules and criteria which are already at present commonly used for the determination of the effects of foreign mandatory provisions of a public law character on the validity of contracts between private persons. As to the suggestion to deal with this kind of provision only in connexion with the problem of impossibility of performance, it was replied that there are public law prohibitions and permission requirements which in fact do relate to the performance of a contractual obligations, and those which on the contrary relate to the validity or effectiveness of the contract itself: while the former would certainly be dealt with in the framework of the chapter on non-performance, the proper place for the consideration of the latter was the chapter on validity.

24. With respect to Article 1 ("Definitions") it was first of all decided to replace, in the third line of paragraph 1, the words "... and they shall be applied ..." by the words "... and which shall be applied ...", and, in the second last line of the same paragraph, the words "irrespective of the law which is applied to the rest of the contract" of the words "whatever the law applicable to the contract".

There was also discussion as to whether the restriction to provisions of a public law nature should be maintained or whether the draft should not also refer to corresponding provisions of a purely private law character (e.g. rules prohibiting smuggling, traffic in drugs, prostitution, the export or import of certain kinds of arms, etc.). Against the inclusion of the latter it was pointed out that this would give rise to considerable difficulties in practice, since, apart from a few exceptions, the national rules on "immoral" contracts are nowadays often based on very different policy considerations. Although it was recalled that the same argument could very well be adduced also with respect to the public law provisions, and that in any event it would seem to be extremely difficult to find a clear dividing line between the two categories of rules, the majority of the Group eventually decided to accept the restriction as suggested by the draft, subject to a better definition of what is to be intended by "public prohibitions" and "public permission requirements".

Finally, it was suggested to refer in paragraph 3 only to those permission requirements the denial of which entails the nullity of the contract. In this respect it was however pointed out that the practical result of a formal refusal to grant the required permission cannot but be the invalidity of the contract, whereas by referring to the concept of "ineffectiveness" it was intended to define the situation which exists as long as the same permission is missing but can still be obtained.

25. As to Articles 2 ("Prohibitions") and 3 ("Permissions"), the discussion was due to lack of time mainly focused on the basic principle laid down therein, according to which the validity or effectiveness of a contract may be affected not only by the "public prohibitions" or "public permission requirements" of the lex fori, but also by similar provisions belonging to the lex contractus or even to the law of other States, provided that the contract has a "significant connection" with that law.

Some members voiced strong opposition to the adoption of such a principle in the proposed Code. The majority of the Group, however, was in favour of the basic idea underlying both Article 2 and Article 3 paragraph 1, though admitting that it represented a considerable change in the traditional way of handling the question of the relevance of public law provisions emanating from foreign States.

Several reservations were however entered as to the present formulation of the two provisions. First of all it was suggested combining the two sub-paragraphs a) and b) into one single provision. It was further pointed out that the present criterion of "a significant connection" with the contract was too vague to determine which national laws must actually be taken into account for the purpose of the two articles of the draft. According to one view the word "significant" should be replaced by the word "close". According to another view, what was really needed was to add to this criterion of a purely geographical nature another one enabling the parties and, in the last instance, the judge or arbitrator, also to proceed to an evaluation of the content of the various conflicting foreign provisions, so as to determine the extent to which their claim for application may be justified in the given case. In the connexion, reference was made to Article 7 of the European Convention on the Law Applicable to Contractual Obligations and to Article 18 of the recent Swiss Bill on Private International Law, which both admit in principle that effect may be given to the mandatory rules of the law of those States with which the contract has a close connection, but at the same time provide that in deciding whether in practice to give effect to these mandatory rules "... regard shall be had to their nature and purpose and to the consequences of their application or non-application", or "... les intérêts en faveur de l'application ou de la prise en considération de cette loi doivent être tenus pour légitimes, en raison des circonstances de l'espèce et des buts poursuivis par cette loi". Another formula which was suggested was that "... due weight should be given to the reasonable interest of international trade on the one hand and to the legitimate interest of the enacting State on the other".

Turning to the remaining part of Article 3, it was first of all felt that the various paragraphs should be regrouped and placed in two separate articles, the one containing the present paragraphs 2 and 5 and the other paragraphs 3, 4 and 6. It was also decided to replace in paragraph 3 the words "shall seek to obtain" by the formula "is obliged to apply for" or "shall take such measures as are necessary to obtain", so as to make it clear that the obligation placed upon the party is of a truly legal and not of a merely moral nature. Furthermore, the question was raised as to whether the party in the case of non-fulfillment of his obligations under paragraphs 3 to 5 should be held liable for damages, and if so, whether the other party's right of compensation should be limited to negative interest or might also cover positive interest. As to the first question the answer was generally in the affirmative, and it was suggested that a new provision should be included in the draft stating at least the principle of liability for damages. As to the

second question, opinions were divided but according to the prevailing view damages are limited to negative interest, that is to say the other party entitled to ask to be put in the position he would have been in had the contract become effective. Several members finally raised the question of the exact meaning of the concepts of "effectiveness" and "ineffectiveness". It was suggested that a different formula be found for defining the exact status of the contract before the permission requirement has been granted, and in this respect particular attention should be paid to the provision laid down in paragraph 6, according to which the parties may under certain circumstances "withdraw" from the contract, notwithstanding the "ineffectiveness" of the latter.

26. With respect to Article 4 ("Party with more than one places of business") the view was expressed that, since it had been decided to delete in both Article 2 and Article 3 paragraph 1 the provision contained in sub-paragraph (a), the present article was no longer needed. This view was however rejected on the ground that it was still necessary to make it clear that the fact that a party has his place of business in the State enacting the prohibition or permission requirement should in itself not be considered as being sufficient for the purpose of the application of Articles 2 and 3 paragraph 1; if the same party has also a place of business elsewhere and the contract is not otherwise closely connected with the law of that State. It was quite a different question whether one should go even further and expressly state that a party with more than one place of business may not rely on any prohibition or permission requirement, if one of his places of business is situated in a State where such a prohibition or permission requirement does not exist. Some members expressed the fear that such a provision could in practice induce the parties to establish their places of business with the sole purpose of escaping the application of mandatory provisions which States normally impose for the protection of legitimate interests. Other members pointed out that it might on the contrary very well be in the interest of one of the parties to get out of the contract. It was therefore even necessary expressly to exclude the possibility of the parties invoking any prohibitions or the lack of permission requirements enacted by a particular State, whenever the contract could be validly performed through one of their branches operating in another State. With a view to finding a compromise solution between the two conflicting views it was finally suggested adopting the following provision: "A party may not rely on any prohibition or permission requirement applicable according to those Rules, where he can reasonably be expected to perform the contract by a branch operating in a State where no such prohibition or permission requirement exists". According

to such a provision the decision on whether or not a party with more than one place of business may rely on any prohibition or permission requirement enacted in one particular State was no longer an automatic one, but depended on the circumstances of each single case, i.e. on whether or not such a party could reasonably be expected to perform the contract by a branch operating in another State. In this connexion it was however pointed out that quite often a large enterprise operates abroad not through simple branches, but by means of affiliated companies or subsidiaries. Should the proposed rule be extended also to these cases? According to one view the answer was yes, since subsidiaries, notwithstanding their legal status of independent companies cannot from an economic viewpoint but be considered part of one and the same enterprise. Other members however took the opposite view. First of all, because the doctrine of "piercing the corporate veil", on which such a solution apparently was based, was far from being universally accepted; secondly, because this was certainly not the proper place to touch upon such extremely complex and delicate questions of company law.

27. As to Article 5 ("Prohibitions and permission requirements to be observed") the fear was expressed that the provision laid down in paragraph 2 could in practice be invoked so as to enforce instruments, such as the Code on the Transfer of Technology or the Code on Restrictive Trade Practices, which, though worked out at international level, cannot be considered to be legally binding on the single States. It was therefore suggested deleting the paragraph altogether.

28. As to Article 6 ("Prohibitions and permission requirements concerning individual terms of contract") according to one view the rule therein laid down was totally unacceptable. It was argued that if it was already difficult for the parties to know in advance all the prohibitions or permission requirements which under the present draft might affect the validity or effectiveness of their contract as a whole, this was even more the case with respect to the kind of prohibitions or permission requirements envisaged in this article, that is to say those which relate only to individual terms of the contract. Nor would it be a fair solution simply strike out the single term affected by such public law provisions, and to uphold the rest of the contract. As a matter of fact, only the parties themselves would be in a position to decide whether or not such an amputated contract was still of interest to them. In rejecting this view the overwhelming majority of the Group drew attention to the fact that cases of partial invalidity of a contract are commonly admitted in most existing national legislations. As to the argument that the rest of the contract should not automatically be upheld, it was first of all pointed out that already according to the existing

text of Article 6 the contract is to be considered as being concluded without the invalidated term only if "having regard to all the circumstances of the case, it is reasonable to uphold the contract in the absence of this term". However, in order to make it clear that the ultimate test should be the intention of the parties, it was suggested redrafting the last three lines of the article so as to read "... the contract shall be considered to be concluded without the corresponding term, unless it becomes apparent that the parties would not have concluded it without that term".

29. No particular discussion took place on Article 7 ("Mandatory character of the rules"). It was merely pointed out that according to this provision the parties are free to exclude the application of, or to derogate from, Article 6.

ANNEXE

ANNEX

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