



UNIDROIT 1989
Study L - Doc. 43
(English only)

U n i d r o i t

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

WORKING GROUP FOR THE PREPARATION OF
PRINCIPLES FOR INTERNATIONAL COMMERCIAL CONTRACTS

Chapter IV

MISTAKE, FRAUD, THREAT AND GROSS DISPARITY

(Revised Draft and Explanatory Report prepared by
Professor Ulrich Drobnig, Director, Max-Planck-Institut
für ausländisches und internationales Privatrecht,
Hamburg, and Professor Ole Lando, Institute of European
Market Law, Copenhagen)

Rome, January 1989

1. The Institute
2. The Institute
3. The Institute

2. The Institute

The Institute is a non-profit organization that is dedicated to the study and research of the history and culture of the United States. It is a 501(c)(3) organization and is exempt from federal income tax.

The Institute is a 501(c)(3) organization and is exempt from federal income tax. It is a non-profit organization that is dedicated to the study and research of the history and culture of the United States.

3. The Institute

The Institute is a 501(c)(3) organization and is exempt from federal income tax. It is a non-profit organization that is dedicated to the study and research of the history and culture of the United States.

The Institute is a 501(c)(3) organization and is exempt from federal income tax. It is a non-profit organization that is dedicated to the study and research of the history and culture of the United States. The Institute is a 501(c)(3) organization and is exempt from federal income tax. It is a non-profit organization that is dedicated to the study and research of the history and culture of the United States.

NOTE

This consultative document is circulated for comment only. It does not represent the final views of the Institute.

CHAPTER IV

Substantive Validity

(proposal)

Article 0 (proposal)

(Validity of mere agreement)

(1) A contract or any subsequent modification of its terms is not invalid because of lack of consideration (for the reason that there is no consideration).

(2) A contract is not invalid for the reason that (because) no performance has yet been rendered.

Article 1

(Definition of mistake)

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

Article 2

(Relevant Mistake)

(1) 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, in accordance with the principles of interpretation [laid down in chapter III], is of such importance that a reasonable person in the same situation as the party in error would have contracted only on materially different terms or would not have contracted at all if the true state of affairs had been known; and

(b) 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.

(2) However, a party may not avoid the contract, if

- (a) it committed the mistake with gross negligence, or
- (b) 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.

Article 3

(Mistake in expression or transmission)

A mistake in the expression or transmission of a statement made in the course of formation of a contract shall be considered as the mistake of him from whom the statement emanated.

Article 4

(Remedies for non-performance 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 non-performance.

Article 5

(Fraud)

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.

Article 6

(Threat)

A party may avoid the contract when he has been led to conclude it by an unjustified threat, from whatever person it emanates, which, having due regard to the circumstances, 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 it is unlawful to use it as a means to obtain the promise.

Article 7
(Gross disparity)

A party may avoid a contract if at the time of its making there is a gross disparity between the obligations of the parties or there are contract clauses grossly upsetting the contractual equilibrium, which is unjustifiable. Regard is to be had to, among other things,

(a) the fact that the other party has taken unfair advantage of the avoiding party's 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.

Article 8
(Initial impossibility)

(1) The fact that at the time of the conclusion of the contract the performance of the assumed obligation was impossible shall not affect the validity of the contract.

(2) The fact that at the time of the conclusion of the contract a party was not entitled to dispose of the assets to which the contract relates, shall not affect the validity of the contract.

Article 9
(Third persons)

(1) Where a fraud, a gross disparity or a party's mistake is imputable to, or is known or ought to be known by, a third person for whose acts the other party is responsible, the contract may be avoided under the same conditions as if it had been concluded by the other party himself.

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

Article 10
(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. 14) expressly or impliedly confirms the contract.

Article 11
(Rectified contract)

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

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

Article 12
(Adaptation of the contract)

(1) If in cases covered by Article 7 avoidance of the contract would lead to an undue hardship to one of the parties, the court [or arbitrator or conciliator or any other third person] may, at the request of that party, adapt the contract in order to bring it in accordance with reasonable commercial standards of fair dealing.

(2) The rules stated in Art. 11 para. 2 apply accordingly.

Article 13
(Notice of avoidance)

Avoidance of a contract must be by express notice which must reach the other party.

Article 14
(Time limits)

Notice of avoidance must be given within a reasonable time, with due regard to the circumstances

- (a) in the case of mistake, fraud or gross disparity, after the avoiding party knew of it;
- (b) in the case of threat, after the avoiding party has become capable of acting freely.

Article 15
(Partial avoidance)

If the parties regard a contract or an individual term of a contract as severable and a ground of avoidance affects only such a severable part or term, avoidance is limited to this part or term of the contract if, giving due consideration to all circumstances of the case, it is reasonable to uphold the remaining contract.

Article 16
(Retroactive effect of avoidance)

Avoidance shall take effect retroactively, subject to any rights of third parties.

Article 17
(Restitution and damages)

(1) 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 according to the rules on restitution (chap. VI arts. 34-35).

(2) A party may also be awarded damages according to the rules on damages (chap. VI arts. 15 ss.).

Article 18

(Mandatory character of the provisions)

(1) The provisions 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.]

Article 19 (proposal)

(Illegality)

The Principles do not affect the conditions and consequences of illegality of a contract.

Article 20 (proposal)

(Unilateral declarations)

Unless otherwise provided in these Principles, the provisions of this chapter apply accordingly to declarations which are addressed by one party to the other after the conclusion of the contract and to other unilateral declarations.

EXPLANATORY REPORT

Introductory Remarks

1. The provisions of art. 1 - 18 of this chapter dealing with substantive validity of international contracts are essentially based upon the UNIDROIT Draft of a Law for the Unification of certain rules relating to validity of contracts of international sale of goods of 1972. (Text and explanatory report in *Revue de droit uniforme / Uniform Law Review* 1973 I 60 ss.).

2. Neither the Uniform Law on the International Sale of Goods of 1964 (ULIS) nor the U.N. Convention on Contracts for the International Sale of Goods of 1980 (CISG) deal explicitly with the validity of international sales contracts. Rather, both uniform instruments, in identical terms, expressly declare that their provisions are not concerned with the validity of the contract or of any of its provisions or of any usage (ULIS art. 8 sent. 2; CISG art. 4 sent. 2 lett. (a)).

3. The revision of the UNIDROIT text of 1972 was prepared by the authors of this report with the following purposes in mind:

a) to emancipate the earlier text from its sales context and to adapt it to a general instrument on international contracts;

b) to take into account new legislative texts which have been enacted within the last 20 years, especially the Algerian Civil Code of 1975; Czechoslovakian International Trade Code of 1963; German Democratic Republic Law on International Economic Contracts of 1976; Israel Contracts (General Part) Law of 1973; Netherlands New Civil Code Books 3 and 6 of 1980; New Zealand Contractual Mistakes Act of 1977; Portuguese Civil Code of 1966; United States Restatement of Contracts 2d (1979).

Also the comparative study and proposals of Rodière, *Les vices du consentement dans le contrat* (1977) has been taken into account;

c) to supplement the earlier text by one or more rules dealing with unconscionable contracts, in accordance with a mandate given by the Full Committee at its meeting in September 1979.

4. The subject-matter of the following provisions requires brief comment.

A rule on formal validity is contained in chap. II art. 1. It may be considered to move this rule to the present chapter which could then be titled "Validity".

Questions of capacity have been omitted. Lack of capacity of natural persons will very rarely affect an international contract.

The problem of a legal entity concluding a contract ultra vires occasionally arises in international transactions; but it seems appropriate that this question be dealt with by rules on legal entities rather than by rules on contract law.

Article by article commentary

Article 0

a) Art. 0 establishes the general rule that mere agreement of the parties creates valid contractual obligations. Par. 1 applies this general rule to two different phases of the contractual process, viz. the initial agreement of the parties and a subsequent modification of its terms.

b) Under Anglo-American law, the lack of consideration is a major obstacle to the initial validity of a contractual agreement. However, in commercial practice this requirement is of minimal importance. Since almost all commercial contracts provide for both a performance and a counterperformance, the requirement of consideration is nearly always satisfied. Nevertheless, in order to dissipate any doubt as to the few remaining situations it is useful to remove the requirement of consideration.

c) The requirement of consideration is also an obstacle to a freely agreed modification of a contract, provided a contractual modification conveys a benefit only to one of the parties. For international sales, the Vienna Sales Convention of 1980 art. 29 par 1 has abrogated the requirement of consideration with respect to modification and termination by providing that a contract "may be modified or terminated by the mere agreement of the parties". This provision should be extended to all commercial contracts.

d) Another obstacle against the initial validity of mere agreements exists in those Civil Law countries which distinguish "real" from "consensual" contracts. The former type of contracts only becomes valid after the party who has promised to lend money or to take a deposit has in fact given the money or received property in deposit. This view runs counter to modern business expectations. While it has been overcome in most countries, a few others, like France, still maintain the old position. It should therefore be abrogated by doing away with the requirement of such part performance.

e) The general principle stated in art. 0 may be extended to instances other than those mentioned in the provision. One example would be an agreed termination of a contract which under certain conditions may not be effective in view of the requirement of consideration.

Article 1

a) This provision offers a definition of mistake which contains two essential elements.

b) The first is that a mistake of law shall be treated in the same way as the traditional mistake of fact. This equation of the two types of mistake follows the view increasingly accepted in the legal systems of the Civil Law as well as in the Common Law.

c) The second and more important aspect of the definition is its time element. The erroneous assumption giving rise to a mistake

must relate to facts, or to the law, as they existed at the time of the conclusion of the contract. The purpose of fixing this time element is to delimit the areas in which the applicable remedies are to be based on the law of mistake on the one hand, and on the rules relating to non-performance on the other hand. This delimitation is necessary because these two sets of rules differ everywhere and the same factual situation may be regarded either as a mistake or as an obstacle preventing performance of the contract, or making it more difficult. The former view will prevail where attention is focused on the (mistaken) assumption on which the party acted when entering into the contract; the latter view will be taken if one looks at the situation as it exists at the time when the contract is to be performed and if one then asks whether there is a sufficient reason to exempt the party from liability for non-performance.

d) The borderline between the rules on mistake and those on non-performance was drawn by using a criterion which seems to be reasonably clear as well as conforming to most legal systems. Specifically, the Netherlands (art. 6.5.2.11 par. 2) and the United States (Restatement, Comment a on par. 151) have recently adopted the same criterion.

e) Sometimes it may be difficult to decide whether or not the fact to which the mistake relates arose before the contract was concluded; yet these difficulties do not seem to be insuperable. If a party is mistaken as to the factual situation existing at the time of entering into the contract and, on the basis of this mistake, misjudges certain future developments which are relevant for its assent to the contract, then the rules on mistake will be applicable. On the other hand, if the party correctly understands the facts as they exist when he enters into the contract but draws wrong conclusions from those facts and, after being disappointed by the actual course of events, refuses to perform the contract, this is a case of non-performance, and not of mistake.

Article 2

a) This provision states the conditions under which one party may avoid a contract on the ground of mistake. The mistake must be (par. 1) essential (a) and the co-contractant of the party claiming avoidance either must have made the same mistake or he must have caused the mistake or he must have or ought to have known of the mistake, having left the mistaken party in error (b). However, avoidance will be excluded under the conditions of par. 2.

b) According to par. 1 lett. (a) a mistake must be "of such importance that a reasonable person in the same situation as the party in error would have contracted only on materially different terms or would not have contracted at all if the true state of affairs had been known".

The drafters have chosen an open-ended formula rather than defining, as some Codes do, certain items (e.g. the subject-matter, or the quality of performance) as "essential" because such statutory enumerations have always to be restricted or supplemented by the intention of the parties. In applying the text, the principles of interpretation, as laid down in chapter III have to be applied. Usually an actual common intent of both parties or an actual intent of one party that was known or ought to have been known by the other party as to the importance of the mistake will not exist. Then the intent of the parties has to be established by ascertaining the intent that reasonable parties would have had under the same circumstances. In this connection applicable usages and the meaning given in the trade concerned to expressions, provisions and contractual forms that were used by the parties will be of particular relevance. In commercial transactions avoidance of a contract will, therefore, as a rule be denied if the mistake relates, for instance, to the value or the marketability of the goods or to mere motivations or expectations of the parties or to minor contractual points not normally considered as essential in the trade concerned. Also, a

mistake as to the person of a contracting party or as to his personal qualities may be an important factor, although in most commercial transactions this will very rarely occur. Each case will have to be determined on its particular facts. It is impossible to offer more than a general formula.

c) Par. 1 lett. (b) establishes several additional but alternative reasons in the person of the co-contractant of the mistaken party, one of which must be fulfilled in order to allow avoidance of the contract. The underlying basic idea is that the interests of the mistaken party alone do not justify avoidance to the detriment of the other party, unless the latter's reliance upon the concluded contract for some reason or other does not deserve protection. Letter (b) enumerates three specific situations in which it appears justified to impose avoidance of the contract on the co-contractant because the latter was intimately connected with the mistake of the mistaken party.

d) One situation arises where both the party claiming avoidance and his co-contractant laboured under the same mistake when they entered into the contract. If both parties, in concluding the contract, acted on the basis of the same mistake, both parties should also bear the risk of losing the contract. It should be kept in mind, though, that no right to avoid the contract exists where the mistake relates to a fact arising after the contract has been concluded (cf. art. 1). It seems that most "common mistakes" fall into that category. Further, if the parties erroneously believe the object sold to be in existence at the time of contracting, while in reality it had already perished, the special rule of art. 8 applies.

e) In "unilateral mistakes" (i.e. those that have not been shared by the co-contractant of the mistaken party) the co-contractant of the mistaken party will ordinarily be protected in his reliance on the contract, except in two situations described in par. 1 lett. (b).

f) The first arises if the co-contractant of the mistaken party caused the mistake. As in the Anglo-American doctrine of innocent misrepresentation, a party's mistake is to be considered as "caused" by the other party if it can be traced to specific implied or express representations of the other party or to conduct which, according to the circumstances, is equivalent to such representations. Also, silence of the co-contractant may cause the mistake. Mere puff used in advertising or in negotiations in itself, is nowhere considered to be a representation. If the mistake was caused intentionally art. 5 will apply. In the context of lett. (b), however, it is immaterial whether or not the conduct of the party causing the mistake was reprehensible. Even though that party may have been totally free from blame, he caused the mistake if the course of events leading to the mistake undeniably originated in his sphere. Under these circumstances it seems fair to impose upon the co-contractant the loss of the concluded contract, by allowing avoidance to the mistaken party.

g) The co-contractant of the mistaken party also does not deserve protection of his reliance on the contract where he knows or ought to have known of his co-contractant's mistake and did not clear up the matter, even though reasonable commercial standards of fair dealing would have required him to do so. In accordance with art. 13 ULIS, the expression "knew or ought to have known" refers to what should have been known to a reasonable person in the same situation. Knowledge of the mistake by the co-contractant only justifies avoidance if the co-contractant, under reasonable commercial standards of fair dealing, was obliged to inform the mistaken party of his error. If there was no such obligation, the mistaken party cannot avoid.

h) Par. 2 describes situations where the mistaken party cannot avoid the contract. It would not be fair to allow the mistaken party to invoke a mistake when it is due to his gross negligence (lett. (a)). Further, lett. (b) provides that the mistake must not relate to a matter in regard to which the risk was expressly or impliedly assumed by the mistaken party. It may be argued that

this case is already covered by par. 1 lett. (a), since a mistake for which the mistaken party assumed the risk will not be essential in the sense described in (a). However, a special provision appeared preferable in order to avoid any doubt and to emphasize the importance of this point. An example of an assumption of the risk of mistake is an error as to the quality of goods that were bought "as is". Quite generally the risk of mistake will have been assumed by the mistaken party if the contract bears for him a speculative element, because at the time of concluding the contract he does not fully know all the relevant facts. The same is true if both parties consciously contracted under an uncertainty (e.g. if a picture "attributed" to the not very prominent painter X. is sold, and later it turns out to have been painted by the famous painter Y.).

Article 3

a) This provision equates an error in the expression or transmission of a statement of intention to an ordinary mistake. The conditions for, and the effect of avoidance are, therefore, also governed by arts. 2 and 9 to 17. In addition, it is expressly provided that such an error is considered as a mistake of the person who made the statement (and not of the receiver). Thus it is only the declarant or sender of the statement who is entitled to avoid the contract under the conditions of art. 2, for mistake under art. 3. In some cases the risk of an essential mistake occurring in the transmission of a telegram will impliedly have been assumed by the sender so that he may not avoid the contract (see art. 2 par. 2 lett. (b)). If the sender has not assumed the risk, avoidance of the contract is only possible if the conditions of art. 2 par. 1 lett. (a) and (b) are met. Thus, if the receiver has desired a reply by wire, he may be considered as having caused a mistake that occurs in the transmission of the telegram (see art. 2 par. 1 lett. (b)).

b) If the receiver misunderstands the true meaning of a telegram that has been correctly transmitted, this is not a mistake in

transmission. Therefore, the general rule of art. 2 applies and not the special rule of art. 3.

[c) The provision only applies to declarations made in the course of formation of a contract; this covers, of course, also agreed amendments of the contract or its agreed termination. Whether the provision applies to other communications or notices, depends upon the purposes of the rules prescribing them (see, e.g., for a differing rule CISG art. 27).]

Article 4

a) Art. 4 provides that a party shall have no right to avoid a contract for mistake where the circumstances on which he relies afford him a remedy for non-performance of the contract, or could have afforded him such a remedy. The latter clause envisages the situation where general remedies for breach of contract had been available, but do no longer afford a remedy, e.g. because of lapse of a statutory time period.

b) In the context of international sales governed by ULIS, art. 4 supplements arts. 34 and 53 ULIS. These provisions limit the buyer to the rights provided by the ULIS and exclude all other remedies, where there is a lack of conformity of the goods or where the goods are subject to a right or claim of a third person. Art. 4 is meant to cover also those cases in which the buyer might have relied on a remedy under the ULIS if, in the circumstances, those remedies had not been barred (for example, because the lack of conformity is immaterial or the buyer has not given prompt notice, arts. 33 par. 2, 39 par. 1 ULIS).

CISG has no express provision corresponding to arts. 34 and 53 ULIS. Nevertheless, most commentators agree that the same result obtains as under ULIS.

c) Avoidance for mistake may apply (more often) to protect a supplier of goods who was mistaken as to the quality of his

performance since that circumstance does not usually furnish him a remedy for non-performance of the contract.

d) The preference of non-performance remedies over avoidance is acceptable with respect to contracts of sale, although the national legal systems remain divided even on this narrow issue. However, the majority of the group had hesitated to extend this preference to contracts in general, as long as rules on non-performance had not yet been drafted. The rules on damages and termination now drafted appear to offer satisfactory remedies to the mistaken party. It is therefore recommended to remove the square brackets.

Article 5

a) According to art. 5, a contract may be avoided for fraud if a party has been led to conclude it by the other party's fraudulent misrepresentation. This is in accordance with the view taken in most legal systems. A more specific description of the fraudulent practices that must be applied would be superfluous, because such formulae would not add to the substance of the provision nor would they significantly facilitate the task of the judge. Mere puff in advertising or negotiations in itself does not suffice.

b) Fraud may also be caused by silence. As distinct from a mistake caused by silence in the meaning of art. 2 par. 1 lett. (b), silence only causes fraud if it is designed by the co-contractant to produce an error on the part of the mistaken party. However, as is also provided in art. 2 par. 1 lett. b), the non-disclosure must relate to circumstances which according to standards of fair dealing the other party should have disclosed.

Article 6

a) Art. 6 confers a right of avoidance on a party who has been led to conclude the contract by an unjustified, imminent and serious threat. The imminence and the seriousness of the threat are to be evaluated on an objective basis which, however, must

take into account the circumstances of each case. The provision may also cover some cases of economic threat (e.g. where a party for whose benefit an "on demand" guarantee has been issued, without valid reason indicates that he will demand payment unless the other party agrees to prolong the duration of the guarantee). Following some recent enactments, the second sentence describes by way of illustration two examples of an unjustified threat. The first is, where the act or omission which has been threatened, is unlawful; the second is, where the act or omission threatened is lawful, but the purpose which is sought to be achieved is unlawful.

b) Contrary to many legal systems, threats emanating from a third person are equated to threats from the co-contractant. 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.

Article 7

a) This provision has been patterned upon the model of a number of recent statutory texts enacted in several countries (e.g. Algeria, Denmark, Israel, United States, West Germany). It permits a party to avoid a contract in cases where, 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. The gross disparity must be unjustifiable. The provision is not a general rule on lésion.

b) The disparity must exist at the time of the making of the contract. A contract or contract clause which, though not unconscionable when made, has become so later may be revised or set aside under the rules on frustration provided in chapter V sect. 2.

c) As the term "gross disparity" denotes, the requirements for the application of the rule are strict. A disparity between the

value and the price or some other element which upsets the equilibrium of performance and counterperformance is, even if considerable, insufficient for refusing the enforcement of the contract. Only if the disequilibrium is of such extent as to shock the conscience of the court is there a gross disparity. The provision does not aim at introducing the idea of contractual justice into each contract.

d) Further, the gross disparity must be unjustifiable. Whether this requirement is met with will depend upon an evaluation of all the relevant circumstances of the case. Two factors have been considered to deserve special attention.

e) One is the fact that the other party has taken unfair advantage of the avoiding party's dependence, economic distress or urgent needs, or his improvidence, ignorance, inexperience, or lack of bargaining skill (lett. (a)). Here it should be emphasized that the dependence mentioned must generally be one which exists outside of the market situation. Thus, the rule does not apply to all cases where a seller, because of his dominant market position, is able to fix the price of his goods. However, such situations may be covered by the rules on monopolies which are not treated in this chapter.

f) The other factor to be especially regarded is the commercial setting and the purpose of the contract (lett. (b)). There are situations where a gross disparity is unjustifiable even if the party who will benefit from the disparity has not taken unfair advantage of the other party's dependence, etc. as described in lett. (a).

Whether this is the case will often depend upon the commercial setting and the purpose of the contract. Thus, a clause exempting a seller of goods from liability for misrepresentation as to the fitness of the goods for a certain purpose may be unconscionable in cases where the seller is an expert who offers the goods to customers without any expertise, but may be upheld as valid in

cases when the customers are merchants of the same branch having the same expert knowledge as the seller.

g) In contrast to the traditional rule followed in most countries but in accordance with recent enactments, gross disparity gives rise to avoidance of the contract but does not imply its nullity. The disparity is not treated differently from threat.

Article 8

a) Art. 8 deals with certain consequences that flow from an initial impossibility of performance and from the seller's lack of ownership of the assets sold.

b) Most legal systems declare a contract of sale to be void if the specific asset sold had already perished at the time of the conclusion of the contract. If one of the parties knows about this initial impossibility of performance, the other party is sometimes awarded damages. Following judicial practice, some modern legislation and advanced modern doctrines, par. 1 takes the opposite view and declares that in such a case the contract of sale is valid. An initial impossibility of performance is thus put on the same footing as an impossibility of performance occurring after the conclusion of the contract. There appears to be no reason to make the validity of the contract depend upon the accidental fact that the asset sold has perished before or after the conclusion of the contract. The rights and obligations of the parties that arise from the seller's inability to deliver the perished goods are determined according to the flexible rules on non-performance. Under these rules it will be possible to attach due weight to, e.g. the seller's knowledge of the destruction of the sold goods at the time of contracting. This solution also removes doubts concerning the validity of contracts for the delivery of goods to be manufactured.

c) Paragraph 2 excludes the rule of certain countries that deem a contract, especially a contract of sale, void if the seller did not own the sold asset. Paragraph 2 is drafted broadly so as to

encompass any rule of a comparable bearing that may exist for other types of contract. The rights and duties of the parties are to be determined by the rules relating to a valid contract, especially those on non-performance.

d) Avoidance of the contract for mistake of for any other ground if the conditions of art. 2 ss. are met, is not excluded.

Article 9

a) This provision regulates in a general manner the consequences that follow for defects of consent if third persons have participated in the contracting process. Paragraphs 1 and 2 distinguish according to whether the third person is acting for a contracting party (as agent or other type of middleman) or not.

b) In the former case, the contracting party whose consent has been affected by the third person acting for the co-contractant may avoid the contract as if it had been concluded by the co-contractant himself (par. 1). Also the state of mind of the third person which is relevant especially for applying art. 2 par. 1 lett. (b), is in this case attributed to the co-contractant. These rules are fairly obvious.

c) If, on the other hand, a third person has acted for whom the co-contractant is not responsible, then the contract may only be avoided in cases of fraud or gross disparity, if the co-contractant knew or ought to have known of the fraud or the abuse (par. 2), for only then is it imputable to him. If the co-contractant was innocently ignorant of the fraud or the gross disparity, the contract cannot be avoided to his detriment.

d) It should be noted that in the case of threats by a third person it is irrelevant whether the co-contractant knew of them or not (see art. 6: "from whatever person").

Article 10

This provision has been inserted following the trend of recent legislation. It is also usually provided that confirmation is only effective after the term for giving notice of avoidance has started to run.

Article 11

a) According to art. 11, the co-contractant of a mistaken party may prevent avoidance of the contract by expressing his willingness to perform the contract on the terms intended by the mistaken party.

b) The possibility of adapting the contract to the intention of the mistaken party enables the co-contractant to bind the mistaken party to the intended terms of the contract. The mistaken party may thus be prevented from ridding himself, upon the pretext of his mistake, of a contract which may have become burdensome to him through intervening economic reasons. Such a regard for the interests of the co-contractant in preserving an adapted contract is only justified in the case of mistake and not in other cases of defective consent.

c) The adaptation is effected by a declaration of the co-contractant, to be made promptly after having been informed of the terms of the contract as understood by the mistaken party, or by a corresponding performance. It is not laid down how the co-contractant is to receive the information about the errans' understanding of the terms of the contract. The principle of good faith in dealing (chapter I art. 3) will lead to a solution adapted to the circumstances of the case. The co-contractant's declaration to perform the contract as it was understood by the mistaken party, or a corresponding factual performance, without restrictions or conditions, is binding upon the mistaken party and completes the corrected contract of the parties.

d) The co-contractant's declaration or performance extinguishes the right of the mistaken party to avoid the contract. If the mistaken party had already given notice of avoidance, this declaration loses its effect. On the other hand, the mistaken party may claim compensation if he has suffered damage and is not made whole by the adaptation of the contract (art. 17 par. 2).

Article 12

a) This provision also provides for adaptation of the contract but, contrary to art. 11, requires the intervention of a court, an arbitrator, a conciliator or any other third person having been called upon to decide the dispute. It is a companion of the rule on gross disparity (art. 7). For cases of mistake, art. 11 provides a machinery for upholding a rectified contract. It is not appropriate to uphold a contract which has been made under the impact of fraud or threat because in this case any confidence between the parties will be spoiled.

b) In cases of gross disparity it may often be more reasonable and realistic to revise the contract than to avoid it, especially if it has already been performed wholly or in part. It is expressly spelt out that a court, an arbitrator, a conciliator or any other third person having been called upon to decide the dispute can effect such adaptation of the terms of the contract only upon the request of a party who by an avoidance of the contract would be exposed to an undue hardship. The criterion for the adaptation is to bring the terms of the contract in accord with "reasonable commercial standards of fair dealing".

c) Since for the case of hardship chapter V sect. 2 art. 26 now provides for adaptation of a contract by a court, the square brackets around art. 12 as a whole should be removed; however, they may be retained for other third persons in par. 1.

Article 13

a) This provision sets forth the formal requirements for a notice of avoidance. No specific form is required for the notice. In particular, it is not necessary to bring a judicial action for this purpose, nor must the notice be evidenced by writing nor is it necessary that the specific term "avoidance" be used in the notice. It is also unnecessary to state the reasons for avoiding the contract. But, in practice, a notice of avoidance will probably always be accompanied by some explanation on what grounds the avoidance was based. However, it is necessary that the notice be "express". Mere non-performance of the contract or related forms of conduct, therefore, do not constitute an effective notice of avoidance.

b) Nevertheless, the provision must be interpreted in the light of the general principle of good faith. This may mean that, whenever it was the co-contractant who had committed a fraud, made a threat or abused an unequal bargaining power, the absence of an express notice by the affected party should not always exclude the latter from exercising his rights.

c) The notice of avoidance must reach the other party. The risk of transmission of the notice must be borne by the party wishing to avoid the contract, since the other party has a legitimate interest to consider the contract valid until he actually receives the notice of avoidance.

Article 14

a) According to this provision, notice of avoidance must be given within a "reasonable time". The period of time for giving notice has not been fixed more specifically, because some leeway for judicial discretion seems indispensable in view of the multiplicity of factual situations. A specific period of time would in some cases make it possible for the mistaken party to delay the notice of avoidance, depending on how the market

develops, and thus to speculate to the disadvantage of the other party. Fixing too short a time period may jeopardize the chances of reaching an amicable settlement between the parties. The pendency of negotiations between the parties with a view to reaching a settlement must, in any event, be taken into account in determining the reasonableness of the time of giving notice.

b) No maximum period for avoidance is fixed. Any fixed period may in certain cases be too severe for the innocent party and would probably also meet with opposition from many countries, especially developing countries.

Article 15

a) Following the example of some recent legislation, this provision deals expressly with partial avoidance. The decisive criterion for allowing partial avoidance is whether parts of a contract or individual terms are severable. Such severability is to be determined in the light of the intentions of the parties, especially if these have included a severability clause into their contract.

b) The party invoking partial avoidance of a severable contract must, if need be, allege and prove that it is unreasonable, in view of the circumstances of the case, to uphold the remaining contract.

c) One of the reporters is of opinion that art. 15 should read: "If a contract or an individual term of a contract is severable...". The words "the parties regard" are ambiguous and may cause difficulties in cases where the parties do not agree on whether a contract is severable or not.

Article 16

a) Art. 16 provides that a notice of avoidance (which is effective under the preceding substantive and formal rules) shall have retroactive effect. The contract is regarded as never having

existed, but the rights which third parties may have acquired are not affected.

b) In the case of a partial avoidance, this rule applies, of course, only to the avoided part.

c) Whether in spite of avoidance a contractual choice-of-law clause, a forum clause or an arbitration clause remains valid, is to be decided by the rules applicable to these issues.

Article 17

a) According to par. 1, what has been supplied or paid under the contract, insofar as the latter has been avoided, shall be restored pursuant to the rules on restitution.

b) According to par. 2, damages which the one or the other party or both parties may be entitled to, are to be governed by the general provisions on damages contained in the Rules.

Article 18

a) This provision gives a mandatory character to most of the provisions of this chapter. Of course, the value of this provision may be limited as long as the Rules have not been enacted into national or international legislation. Even so, it is appropriate and necessary to signify clearly the intention of the drafters of the Rules that most of the provisions of this chapter are meant to be mandatory. It would be intolerable and contrary to most national laws if the parties were entitled to exclude or modify the provisions of this chapter relating to fraud, threat, or gross disparity.

b) On the other hand, the provisions relating to mistake and initial impossibility do not partake of such public policy character and therefore need not be made mandatory. Article 2 par. 2 lett. (b) expressly covers already an assumption of the risk of mistake. The parties should also be able to make the

validity of their contract dependent upon the initial possibility of its performance.

c) Some laws, e.g. English law, do not allow to exclude the risk or the liability for a mistake which was caused by the co-contractant's negligent misrepresentation. Indeed, the contractual assumption of the risk of mistake is not designed to cover cases where the mistake has been negligently caused by the co-contractant of the mistaken party. This rule is embodied in par. 2. The reporters wish to maintain this provision. However, it is not consistent with chap. VI art. 31 which invalidates exemption clauses only in cases of deliberate or reckless behaviour. The decision of this issue is submitted to the Commission.

Article 19

The Principles do not purport to regulate under which conditions a contract is illegal and how this affects its validity, such as wagering contracts. The same is true for public prohibitions; examples are contracts violating anti-trust law or foreign exchange regulations. The conditions and effects of any such illegality must be determined under the applicable law.

Article 20

a) The preceding provisions of this chapter regulate the validity of contracts since these are the most important instruments of international commerce. However, also declarations by one party, either within a contractual framework or outside of it, play an important rôle. It is therefore useful to extend the rules on the validity of contracts to unilateral declarations.

b) In a commercial setting, unilateral declarations outside of, but preparatory to, a contract are relevant especially in the form of public invitations for bids for investments, deliveries, works or services.

c) Declarations which after the conclusion of a contract one party may make to another party are provided for under different names, such as notices, declarations, etc. The validity of some of these declarations, notably waivers, may be in doubt. Such declarations may also be affected by a defect of consent. The conditions and consequences for avoidance of such declarations are, generally speaking, the same as those set out in this chapter.

