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WORKING GROUP FOR THE PREPARATION OF PRINCIPLES
FOR INTERNATIONAL COMMERCIAL CONTRACTS

Chapter 6

NON-PERFORMANCE

Section 3: Termination

Section 5: Effects of Termination and Restitution

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SECTION 3: Termination

Article 6.3.1.

(The right to terminate the contract)

- (1) A party may terminate the contract if the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance.
- (2) In determining whether a failure to perform an obligation amounts to a fundamental non-performance the following circumstances are significant
 - (a) whether the non-performance substantially deprives the aggrieved party of what he was entitled to expect under the contract unless the other party did not foresee and could not reasonably have foreseen such result;
 - (b) whether strict compliance with the obligation which has not been performed is of essence under the contract;
 - (c) whether the non-performance is intentional and gives the aggrieved party reason to believe that he cannot rely on the other party's future performance
 - (d) the extent to which the defaulting party will suffer forfeiture if the contract is terminated.

Article 6.3.2. (or 6.1.6.)

(Termination after notice fixing additional period for performance)

- (1) In case of delay in performance the aggrieved party may in a notice to the defaulting party fix an additional period of time for performance. When the delay does not amount to a fundamental non-performance under Article 6.3.1. the additional period, if not of reasonable length, shall be extended to a reasonable length.
- (2) If a defaulting party fails to perform before the time allowed him under paragraph (1) has expired the aggrieved party may declare the contract terminated if he has not already provided for its termination in his notice to the defaulting party.
- (3) Paragraph (2) does not apply when the obligation which has not been performed is only a minor part of the defaulting party's contractual obligation.

Article 6.3.3.
(Notice of termination)

(1) Termination is effective only when made by notice to the other party.

(2) A party will lose the right to declare the contract terminated for non-performance unless he gives notice of termination to the other party after he has or ought to have become aware of the non-performance.

(3) Where no performance has been offered notice in accordance with paragraph (2) is required only when the aggrieved party has reason to believe that the defaulting party intends to offer performance within a reasonable time.

(4) A party to whom performance has been offered late will lose any right he may have to terminate the contract unless he gives notice to the other party after he has or ought to have become aware of the offer.

(5) Notice by the aggrieved party under the preceding paragraphs must be given within reasonable time after that party has become or ought to have become aware of the non-performance (paragraph (2)) the defaulting party's intention to perform (paragraph (3)) or the offer (paragraph (4)).

Article 6.3.4.
(Anticipatory non-performance)

Where prior to the date for performance by one of the parties it is clear that there will be a fundamental non-performance by him, the other party may declare the contract terminated provided he gives notice within a reasonable time after he became or ought to have become aware that due performance would not be made.

Article 6.3.5. (or 6.1.5.)
(Adequate assurance of due performance)

A party who reasonably believes that there will be a fundamental non-performance by the other party may demand adequate assurance of due performance and may meanwhile withhold his own performance. Where this assurance is not provided within a reasonable time the party demanding it may declare the contract terminated.

Comment

A. In General

a) Non-performance must be fundamental

Termination of the contract is often a grave detriment for the defaulting party, and the aggrieved party should therefore not be permitted to terminate the contract in case of a minor failure in performance. Art. 6.3.1., 6.3.2. and 6.3.4. express the principle that termination may be declared only if the non-performance is or will become material or fundamental.

b) Termination also if non-performance is excused

The rules in this part are intended to apply both in cases where the non-performance is attributable to the defaulting party, and where it is excused so that the aggrieved party can claim neither specific performance nor damages for non-performance.

c) Termination operates "de plein droit"

In all cases the termination of the contract is effected by the act of the aggrieved party alone, mostly by giving notice of termination, see art. 6.3.3. If the requirements of art. 6.3.1., 6.3.2. and 6.3.4. are satisfied no period of grace may be granted to the defaulting party in case of delay.

B. The Articles

Art. 6.3.1.

a) The Fundamental non-performance

Art. 6.3.1.(1) states the principle mentioned sub A,a) above. The aggrieved party may only terminate the contract if the defaulting party's non-performance is substantial. This will depend upon a weighing of the interests of the parties in each case. To which extent will the aggrieved party benefit from the performance even if it is late or defectful? How much will a termination of the contract affect the aggrieved party?

b) Significant circumstances

Subparagraph (2) mentions circumstances which influence the determination of whether a non-performance is substantial.

Under subparagraph (2) (a) the non-performance must be so material that the aggrieved party is deprived of what he was entitled to expect at the time of the conclusion of the contract.

Illustration 1.

On May 1, A contracted to deliver standard software before May 15 to B who had requested quick delivery. A tenders delivery on June 15. B can refuse delivery and terminate the contract.

Art. 6.3.1.(2)(b) looks not at the actual gravity of the non-performance but at the assumption in the contract that strict performance by one party is a correlative of the other party's duty to perform. Such obligations of strict performance are common in commercial contracts. For example, it is a rule in many systems of law that in a contract for the sale of commodities time of delivery is of the essence, and that in a documentary credit transaction the documents tendered must conform strictly

to the terms of the credit.

Art. 6.3.1.(2)(c) deals with the situation where the non-performance is intentional or brings evidence of an intention not to be bound by the contract. It may, however, be contrary to good faith to terminate a contract if the breach is insignificant or if it proved to be to the advantage of the obligee. Thus an employee or agent cannot be dismissed if he disobeys instructions from the principal in order to safeguard the latter's interests.

Art. 6.3.1.(2)(d) treats situations where a party who fails to perform has relied on the contract and has prepared or tendered his performance. In these cases regard is to be had to the extent to which he suffers forfeiture if the non-performance is treated as substantial. A non-performance is less likely to be treated as material if it occurs late after a preparation of performance than if it occurs early before such preparation. It is also to be considered whether a performance tendered or rendered can be of any benefit to the defaulting party if it is refused or has to be returned to him.

Illustration 2

On May 1, A contracts to deliver software which is to be produced especially for B. It is agreed that delivery shall be made before December 31. A tenders delivery on January 31. At that time B still needs the software, which A can not sell to other users. B can claim damages from A, but cannot terminate the contract.

Art. 6.3.2. The "Nachfrist"

a) Operation of the "Nachfrist"

Art. 6.3.2. introduces the "Nachfrist" procedure of German law, which is also provided for in CISG arts 47, 49, 63 and 64.

It is meant to operate mainly where there is a delayed performance which is or may not be fundamental. By fixing a reasonable additional time for performance the aggrieved party can make sure that he can terminate the contract if, when this time has expired, the obligor has not performed.

During the additional time fixed the aggrieved party may not claim specific performance or terminate the contract. He may, however, withhold his own performance and he may claim damages for the loss he will suffer from the delay.

The "Nachfrist" may also be given when the delay is a fundamental non-performance. The remedies which the aggrieved party may and may not exercise are then the same, and he may not terminate the contract if the defaulting party performs the contract within the time set for performance.

b) Conditions

In order for the notice to be effective it must be a firm request for performance, and it must be for a fixed period of time. It will not suffice to ask for performance "within a reasonable time" or "as soon as it is convenient". The additional time for performance must be of a reasonable length. The determination of

what is reasonable must ultimately be left to the court. Several factors are significant in this respect, such as the need for the aggrieved party - apparent for the defaulting party - for prompt performance, the nature of the performance - complicated or simple - and the reason for the delay - excusable or not.

When the delay fixed by the aggrieved party is not of a reasonable length it shall be extended to a reasonable length.

Illustration

O hires C to build a wall in C's garden to be completed after 6 months of work on May 1, but prompt completion is not of essence. On May 1 the wall is not finished and C still needs another two weeks to complete it. O gives C four days to complete the wall, and declares that he will consider the contract as terminated if C has not finished it by then. C completes the wall in two weeks. C cannot terminate the contract.

c) Effects

If, after the time fixed for performance has expired, the obligor has not yet performed, the aggrieved party may terminate the contract. The aggrieved party may also in his notice to the defaulting party declare that he will consider the contract as terminated ipso facto, if after the expiry of the period the obligor has not performed.

The aggrieved party cannot terminate the contract for delay if the performance which at the expiry of the period has not been made, relates only to a minor part of the defaulting party's obligation.

Art. 6.3.3. Notice

a) The Requirement of Notice

Art. 6.3.3. rests on the assumption that an aggrieved party who wishes to terminate the contract must give notice thereof to the other party. Uncertainty as to whether the aggrieved party will accept the performance or not may cause a loss to the defaulting party which is disproportionate to the inconvenience which the aggrieved party will suffer from giving notice. A requirement of notice will also prevent the aggrieved party from speculating for a rise or fall in the value of the performance to the detriment of the defaulting party. Notice is therefore required to terminate the contract (paragraph (1)) and it must be given after the aggrieved party becomes or ought to become aware of the non-performance (paragraph (2)).

b) Performance Overdue

When performance is due but has not been made, the aggrieved party's courses of action will depend upon his wishes and his knowledge.

1) He does not know whether the other party intends to perform, and either he does not want the performance or is undecided. In this case he may wait and see whether performance is ultimately tendered and make up his mind if and when this happens, see paragraph (4).

2) He has reason to know that the defaulting party still intends

to perform within a reasonable time. He does not wish to receive performance. In this case good faith requires that he prevents the defaulting party from incurring further effort in performance. He must therefore notify the defaulting party that he will not accept performance, and will lose his right to terminate if the other party does in fact perform within a reasonable time, see paragraph (3).

3) He does not know whether the other party intends to perform, but he wants performance. In that case he must seek it within a reasonable time after he has or ought to have become aware of the non-performance, see article 6.2.2.

c) The Reasonable Time

The aggrieved party who is to give notice must do so within a reasonable time, see paragraph (5). What is reasonable time depends upon the circumstances and must ultimately be decided by the court. Where the aggrieved party may easily get substitute goods or sell the goods, and may thus speculate for a fall or rise in the price of the goods, notice must be given without delay. Where he has to investigate whether he can get substitute performance from other sources the reasonable period of time will be longer.

Art. 6.3.4. Anticipatory Non-performance

The purpose of art. 6.3.4. is that a non-performance which is to be expected is to be equated with a non-performance which has occurred at the time when performance fell due. The requirements are that it is clear that there will be non-performance; a suspicion, even a well founded one, is not enough. Furthermore it is required that the non-performance will be a fundamental one, and that the party who is to receive performance gives notice of termination within reasonable time from the moment he became aware or ought to have become aware of the fact that due performance would not be made.

6.3.5. Adequate Assurance of Due Performance

Article 6.3.5. protects the interest of a party who has reason to believe that the other will not be able or willing to perform the contract at the due date but who is reluctant to invoke article 6.3.4. in a case where there is a possibility that the other party will or can after all perform. In the absence of the rule in article 6.3.5. the obligee will often be in a dilemma. If he waits until the due date of performance and this does not take place he may incur losses. If, on the other hand, he terminates the contract, and it then becomes apparent that the contract would have been performed by the other party, he has committed a non-performance of the contract and will be liable in damages. Article 6.3.5. enables him to obtain an assurance of performance. If he does not obtain that assurance he can declare the contract terminated. The other party is then considered to have made a fundamental non-performance.

It depends on the circumstances which acts by the obligor constitutes an adequate assurance. In some cases the obligor's declaration that he will perform will suffice.

Illustration

A, a boatbuilder with only one berth, has promised to built a yacht for B to be delivered on May 1, and no later. Soon after B learns from C that A has promised C to build a yacht during the same period which will prevent A from preforming his contract with B in time. B is entitled to ask A for an adequate assurance that the yacht will be delivered on time.

In other cases the obligee will be entitled to demand security, or surety from a third person.

So long as the obligee's reasonable belief in future non-performance by the obligor continues he may withhold his own performance until he receives adequate assurance of due performance.

SECTION 5: Effects of Termination and Restitution**Article 6.5.1.****(Effects of Termination in General)**

- (1) Termination of the contract releases both parties from their obligation to effect and to receive future performance, but, subject to article 6.5.2., does not affect the rights and liabilities that have accrued at the time of termination.
- (2) Termination does not preclude a claim for damages for non-performance.
- (3) The termination does not affect any provision in the contract for the settlement of disputes or any other term of the contract which is to operate even after termination.

Article 6.5.2.**(Restitution)**

On termination of the contract either party may claim restitution of whatever he has supplied, provided that he concurrently makes restitution of whatever he has received, or, if he cannot make restitution in kind, makes allowance for what he has received.

CommentArt. 6.5.1. Effects of Termination and Restitutiona) Termination Not Retroactive

Termination releases both parties from their duty to effect and to receive performance. The contract, however, is not cancelled in the sense that it is treated as if it never has been made. Other rights and duties still persist, see para. 2 on damages and para. 3 on dispute settlement and on other rights and duties provided in the agreement such as a covenant not to use or divulge confidential information.

Art. 6.5.1. states the general rule that termination of a contract has no retroactive effect. However restitution is provided for in 6.5.2. when money has been paid or property delivered. In many contracts a literal restoration is not possible. This applies to work and labour, services, the hiring out of goods and the letting of premises, and the carriage and custody of goods. A party who has received a performance of this kind cannot give it back. In contracts for sale or barter restitution may be impossible when the goods have perished or have been consumed or transformed.

In all these situations the party who has received a performance which he cannot return might retribute the value of it and various legal systems provide for such a restitution. Art. 6.5.2. provides for restitution in order to avoid that a party obtains an unjust enrichment.

b) Operation of the Rules Illustrated by an Example

The operation of art. 6.5.1. - 6.5.2. may be illustrated by an example: A sells to B a specified production machinery and discloses to B confidential information which is necessary for the production. B agrees not to divulge the confidential information as long as it has not become publicly known. The contract further contains a clause referring disputes to the courts of A's country. After B has placed the machinery into operation serious defects in the machinery lead to a shutdown of B's assembly plant. B declares the contract terminated and claims damages.

The termination has the effect

that each party must return to the other what he has received, A the payment and B the machinery, see art. 6.5.2.

that B has a duty not to divulge the confidential information as long as it remains secret, see art. 6.5.1.(3)

that B may claim damages for breach of contract, see art. 6.5.1.(2), and

that any dispute relating to the contract and its effects are to be settled by the courts of A's country, see art. 6.5.1.(3).

Art. 6.5.2. Restitutiona) Purpose

Art. 6.5.2. provides for a right for each party to claim back whatever he has received under the contract provided that he concurrently makes restitution of whatever he has received, or, if he cannot make restitution in kind, makes allowance for the

value of what he has received. The purpose of art. 6.5.2. is inter alia to avoid that a termination, which generally has prospective effects only, will lead to an unjust enrichment of one of the parties.

b) Operation

Article 6.5.2. gives a party a right to claim back property which he has supplied under the contract, in case of the other party's non-performance.

Illustration 1

A has sold a Renoir painting to B for 2 million USD. B does not pay for the picture when it is delivered to him. A can claim back the picture.

If the defaulting party cannot make restitution he must make allowance in money for the value he has received. Thus in the case mentioned in Illustration 1, B has to make allowance for the value of the picture if B has sold and delivered it to a purchaser from which it cannot be claimed back.

The rule applies also when the aggrieved party has made a bad bargain. If in the case mentioned in Illustration 1 the true value of the picture is 3 million USD A may still claim back the picture, and if it cannot be restored, claim the true value, 3 million USD.

Article 6.5.2. also applies to the situation where the aggrieved party has supplied money in exchange of property, services etc. which he has not received or which are defective.

Illustration 2

The "Renoir" painting for which B has paid 2 million USD was not a Renoir but a copy. B can claim back the money, and he has to restore the copy to A.

Money paid back for services or work which were not performed or properly rejected should be repaid to the party who paid for it. The same principle apply to custody of goods and rent and lease of property. In these contracts a pro-rata rule will apply when the amount to be paid depends on the period of time during which performance is made. The party who has paid may claim restitution of a payment covering a period of time during which he did not receive performance, either because he properly rejected it, or because the other party failed to provide it.

Illustration 3

A has hired B's premises which B has assured can be adequately heated and A has prepaid 6 months' rent. When he moves in on August 1, he does not discover that the premises cannot be heated. When the cold weather comes on November 1, A immediately moves out. A can claim back rent for 3 months.

c) Restoration impossible or too onerous

The rule in article 6.1.4. on the right to withhold performance apply mutatis mutandis to the restitution of property.

Article 6.2.2. on performance in nature also applies mutatis mutandis to the claim for restitution of property. The aggrieved party cannot claim back goods when it has become impossible or would involve the defaulting party in an unreasonable effort or expense. In these cases the defaulting party must make allowance for the value of the property.

d) Third-Party Rights Are not Affected

Like other articles of these Principles art. 6.5.2. deals with the relationship between the parties and not with the effect which the contract may have on the property in question. Whether, for instance, a creditor of the buyer, the buyer's receivers in bankruptcy, or a bona fide purchaser may oppose the restitution of goods sold is to be determined by the applicable national law.