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Unidroit

International Institute for the Unification of Private Law

WORKING GROUP FOR THE PREPARATION OF
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

SUMMARY RECORDS

of

THE MEETING HELD IN ROME

FROM 16 TO 19 MARCH 1998

(Prepared by the Secretariat of Unidroit)

Rome, June 1998

1. The first meeting of the new Working Group for the preparation of second enlarged edition of the Principles of International Commercial Contracts was held from 16 to 19 March 1998, at the UNIDROIT headquarters in Rome. The list of participants is attached hereto as Annex 1.

2. The Acting Secretary General of UNIDROIT, W. Rodinò, opened the meeting and recalled that, when in the 1960s Mario Matteucci first launched the idea of preparing at international level an instrument similar to the American Restatements of the laws, few could have imagined that the Principles would be the Institute's most successful project whose success has surpassed even the most optimistic expectations. He then welcomed, also on behalf of the President of UNIDROIT, L. Ferrari Bravo, the new members to the Working Group and at the same time expressed his appreciation for the most valuable contribution to the project made by those who no longer participating directly in the work of the Group. He expressed regret for the absence of the members Baptista, Crépeau, Date-Bah and Hartkamp who were unable to attend.

3. Farnsworth recalled Bonell's crucial contribution to the preparation of the first edition of the Principles and proposed that he be confirmed as Chairman of the Working Group. It was so decided.

4. Bonell stated that he was much honoured by the trust placed in him by the Working Group and expressed his hope that the other members of the Group would assist him, as in the past, in this arduous task.

I. REVISION OF THE PRESENT TEXT OF THE UNIDROIT PRINCIPLES

5. In introducing the first item of substance on the Agenda ("Revision of the present text of the UNIDROIT Principles") Bonell pointed out that the content of the Principles had been discussed at numerous seminars and was the subject of a growing number of scholarly writings world-wide. Comments so far expressed had in general been extremely favourable. Critical remarks were few and related to a relatively small number of provisions. Some of them did not even refer to the substance of the provisions but merely concerned the wording and/or the accompanying comments and illustrations. He asked members to report briefly on how the Principles have been received in their respective countries and whether they felt any individual provisions of the Principles required reconsideration.

6. Farnsworth stated that the provisions on hardship were of particular interest in the United States. He was personally involved as an expert witness in an ICC arbitration where the arbitrators thought that the Principles were relevant even though the contract in question had been entered into long before the Principles had been published. One of the questions that had been put to him was whether, if there was an agreement to negotiate in good faith, specific performance was an appropriate remedy. He explained that there was a section in the Principles stating that specific performance

was an appropriate remedy while another section provided that if parties negotiated in bad faith the remedy was essentially recovery of the reliance interest and that the question was how the two provisions could be reconciled. He suggested that when the existing Principles were revised, a comment could be inserted addressing the issue but he did not consider it a defect in the present edition.

7. Fontaine reported that the Principles had raised much interest and discussion in academic and business circles in Belgium and that they had been the subject of articles and had been incorporated in the courses give at several universities. There had also been some criticism of some provisions of the Principles. In his view it would be premature to embark on a revision of the first edition because more feedback was likely be received and because it would be inadvisable politically to commence a revision so shortly after the publication of the the Principles.

8. Bonell recalled that when the question of a revision of the Principles had been discussed by the Governing Council the previous year, the Council was of the same opinion.

9. According to Uchida the Principles were, unfortunately, not very well known yet in Japan. However Bonell's visit to Japan in the previous Autumn had had very positive results. Numerous lawyers and members of the Ministry of Justice had attended his seminars and had become interested in the Principles. Uchida moreover expressed the hope that the full text of the Principles would be translated into Japanese as soon as possible. He, too, believed that it would be premature to discuss a revision of the Principles at this stage.

10. Furmston stated that he came from a country that did not rush to embrace projects like the Principles and that it had, therefore, been a surprise for him to find so many of his compatriots enthusiastic about the Principles in the course of a conference on the Principles organised by Freshfields in London the previous week. He was of the view that item 3 on the agenda should not be addressed until after the completion of item 4.

11. Bonell thanked both Furmston and Freshfields for their efforts in organising the conference which had been a great success indeed.

12. Jauffret-Spinosi stated that, although she was not aware of the application of the Principles in practice, they had received an enthusiastic response from commentators. She was of the view that lawyers considered the Principles a good thing even though they might be reluctant to apply the Principles immediately as they might be a little immature.

13. Komarov stated that in general the Principles had been met very positively by the Russian legal community. Measures had been taken to make the Principles available to lawyers and people involved in international trade. They had been translated

into Russian. Contracts included an increasing number of references to the Principles. The most important role played by the Principles in Russia was in the reform of the legal system and they had played a very important pedagogical role in the preparation of the new Russian civil code. Moreover courses were being taught at Moscow University covering the Principles and legal literature and text books contained references to the Principles. Similarly, a number of awards rendered by the Russian Court of Arbitration referred to the Principles. He announced that he would prepare a summaries of two of these awards rendered in 1997. As to the content of the Principles, he was not aware of any criticism, possibly because the Principles filled the gap between the old legal regime of economic relations and the new. Unlike the position in other states, in Russia there had not been any practical experience and that was why the commentary to the Principles was of particular importance as there was no practice/caselaw on this aspect of the Russian civil law. The only criticism was that the commentary should be more developed and explicit with more written on the application and possible variance of application of the Principles.

14. Bonell pointed out that much of the success of the Principles in Russia was due to Komarov's personal efforts inasmuch as he had not only supervised the translation of the text of the Principles into Russian, but had also recently organised a presentation of them at the Court of Arbitration.

15. Finn stated that the Principles had been somewhat slow to penetrate legal consciousness in Australia but that, nevertheless, Australian law was continually in evolution and the domestic impact of the Principles would depend on how the process evolved. Significant departures had recently been made from English contract law. In his view the impact of the Principles would become significant when Australian law adopted a general principle of good faith and fair dealing. University of Melbourne, the principal law school in Australia, had begun to teach contract law on an international basis and he anticipated that the Principles would be one of the basic texts for the course and this would have a considerable impact on a significant number of lawyers in Australia.

16. Huang stated that the Principles had been very positively received in China. The first Chinese translation of the integral text of the Principles had been made available to the public in August 1996 and the first edition had already sold out. Copies had been distributed to all the arbitrators, People's Congressmen and legislators in China. A unified contract law was currently being drafted in China, the text of which would be promulgated at the end of the year and the drafters had referred to the Principles as a source of inspiration for a number of provisions, covering important aspects of contract law such as formation, right to terminate and performance. She pointed out not only the black letter rules of the Principles but also the comments had proved particularly useful and important and expressed the hope that comments would also be included for the new topics. She added that on her return from Rome she would have to report to the People's Congressmen to suggest possible additions to the draft Chinese contract law and, therefore, felt that even the present Working Group meeting

would have important influence on the development of Chinese contract law. With regard to the practical application of the Principles, to her knowledge the Principles had not been referred to in any arbitral awards, but had, on several occasions, been invoked in pleadings. Similarly, universities had begun teaching the Principles. The Chinese government had expressed interest in hosting one of the Working Group's meetings to be followed by a seminar at the Arbitration Commission.

17. Bonell thanked Huang for her efforts in preparing the Chinese version of the Principles and for hosting in October 1997 very successful seminars in China. Furmston confirmed that the people he had recently met who were involved in drafting the Chinese contract code regarded the Principles as of great significance.

18. Di Majo reported that in Italy too the Principles had fuelled a new discussion on contract law, albeit more in academic circles rather than among practitioners. However in his view the Principles were still not very well known by lawyers, judges and arbitrators. He also felt that Italian jurists did not have too clear an idea as to the difference between the UNIDROIT Principles and the European Principles of Contract Law and he thought that it might be necessary to specify the distinction between the two codes more clearly.

19. Lando reported that academics in the Nordic countries had shown a keen interest in the Principles, and they were increasingly referred to in recent articles and textbooks on contract law which are frequently consulted by judges and arbitrators. Although judgments did not expressly refer to the Principles, it could be inferred that they were influential. He added that on many occasions the Principles had supplemented domestic law, in areas where it had lacunae, and had been sources of inspiration for revision of the law. The Principles were also often used to teach courses in Scandinavian universities, where the growing tendency was to teach European, rather than national, contract law. He envisaged a future when European law students could go to foreign universities and receive their instruction in contract law because there will be a common approach to contract matters and this will be partly thanks to the UNIDROIT Principles. With regard to possible amendments of the present text, he stated that out of the existing 120 provisions, he would only consider modifying four or five. There were, of course, additions which he believed should be made. He supported the idea of collecting and publishing records of cases which referred to the Principles, particularly if they could be made available on the Internet. On the question of the differences between the UNIDROIT Principles and the European Principles, Lando explained that the former were intended to be a restatement relating exclusively to international contracts while the European Principles were more ambitious. They aimed to be a first draft of a European civil code, towards which keen interest had been demonstrated by certain European states, and addressed national as well as international situations. In his view, the fact that the respective groups of experts had been working together, he participating in the UNIDROIT meetings and Bonell in those of the European Commission, had been immensely fruitful. Lando then gave a brief account of the work currently underway within the European Commission. The Commission too planned to expand the scope of

the European Principles and the new topics were broadly similar to those discussed in Doc. 55. In addition the Commission had also discussed the concept of *solidarité active et passive*: joint and several liability and several and joined creditors. The second additional topic was the effects of immorality and illegality on contracts.

20. Schlechtriem reported that the Principles were being taught in several courses at the University of Freiburg, including comparative law and contract law and were the subject of special seminars for graduate students. Furthermore a number of doctoral theses were being prepared on the Principles. In German legal writings the reception was generally quite favourable, although suggestions for amendment had been made for example with respect to the provisions on the effects of termination and avoidance, which did not address the issue of costs incurred in preserving goods prior to returning them to the seller or the question of how to assess the advantage gained from having used the goods, whether ownership in the goods would automatically revert to the seller on termination or whether it would have to be retransferred. He believed, however, that it was still too early to propose amendments. With regard to the use of the Principles in judicial proceedings, he reported that they had often been referred to in pleadings. He was presently the sole arbitrator in an ICC arbitration and hoped to be able to rely on the Principles in reaching the decision.

21. Bonell concluded that there appeared to be consensus that even if the present edition of the Principles required some revision, that should be done at a later stage.

II. REPORTING SYSTEM OF INTERNATIONAL CASE LAW RELATING TO THE UNIDROIT PRINCIPLES

22. Bonell recalled that a number of members of the Working Group had stressed the need for a proper system of collecting and disseminating the growing body of international case law relating to the UNIDROIT Principles. He drew attention to a project currently underway at the Centre of Foreign and Comparative Law Studies (a joint venture between Unidroit, the University of Rome I and the Italian National Research Council, financed by the latter) for the creation of a database on the UNIDROIT Principles modelled on UNILEX, a database on the Vienna Sales Convention which the Centre has been developing since 1992 and which has already gained significant recognition worldwide. Like UNILEX, the new database is intended to provide access to the decisions not only chronologically and country by country but also under the specific issue(s) considered in the case. To this effect a list of the various issues most likely to arise in relation to the individual provisions of the Principles had been developed and under each of these issues all the decisions addressing them will be listed. The decisions will be retrievable in their original full text (where available) and in the form of an abstract. Such a project entails not only considerable investment both in terms of human resources and financial means, but is clearly dependent on an adequate system for collecting the relevant materials from courts and arbitral tribunals. This is particularly problematic as regards arbitral awards on account of their confidential nature. Yet if the

full text could not be published, one might envisage publishing at least summaries of the decisions indicating the type of contract, the nationality of the parties, the manner in which the Principles were used and the specific provision(s) of the Principles relied on. This was precisely what has been done so far. Of the 30 or so decisions collected the great majority are arbitral awards only two of which were available in full text while the others have been reproduced in the form of abstracts. In this connection Bonell regretted the absence of the observer from the ICC Court of Arbitration. This Court, knowingly one of the most important worldwide, has set up a fairly well developed case recording system, yet so far it the official position seems to be to deny access to outsiders including international organisations such as Unidroit.

23. Jauffret-Spinosi offered to try to persuade the ICC Court of Arbitration of the importance of envisaged database on the UNIDROIT Principles.

24. Farnsworth suggested that the busiest arbitrators could be contacted personally with a view to soliciting their assistance with the project. Bonell pointed that this was precisely what he himself had been doing with some degree of success and encouraged all members of the Working Group to make similar inquiries.

25. Finn inquired whether the Principles were available in electronic format. Ms Howarth (Unidroit Secretariat) explained that one section of the official Unidroit Internet Web site was devoted to the Principles including, among others, their integral version, an up to date bibliography and a questionnaire to monitor the application of the Principles.

26. Schlechtriem wondered what the Institute's policy on the Principles was. For example, could they be included as an annex to the third edition of his Commentary on the Vienna Sales Convention? Bonell explained that the Institute's policy was to give the Principles the widest possible publicity. There was no copyright on the black letter rules and the right to publish them had always been granted free of charge. He added that numerous legal journals had already requested permission to publish the Principles. Maybe the time had come to adopt also with respect to the integral version of the Principles a more liberal policy.

III. NEW TOPICS FOR INCLUSION IN THE SECOND EDITION OF THE UNIDROIT PRINCIPLES

27. Moving on to the next item on the Agenda, Bonell opened the discussion on the new topics suggested for inclusion in the second edition of the Principles as set out in UNIDROIT 1998 Study L - Doc. 55, paragraphs 11-60.

28. Di Majo observed that before discussing the individual topics, it would be useful to discuss what form the new edition would take. He envisaged three possibilities: Principles No.2, which would have an independent content of Principles No.1; alternatively, it could be a mere addition to Principles No.1; the third option was

an enlargement of the content of the Principles. The Working Group should give some general consideration to the scope of its work since some of the suggested topics were not contractual topics, but belonged to *loi des obligations* or, like waiver, belonged to general principles of law.

29. Bonell asked Di Majo which option he favoured. Di Majo replied that if the second option were adopted, the Group would have more freedom in determining the content of the second edition which could, even under the title Principles of International Commercial Contracts, address topics which more properly belonged to the law of obligations.

30. Lando suggested that the labelling of the work was a matter of secondary importance. Finn agreed with Lando, adding that the topics for inclusion should be considered bearing in mind they related to international commercial contracts. Only once the raw material had been examined should the Group address the specific issue of what was being created. Also according to Komarov the title of the work was not of crucial importance at the present stage, but Principles 2 should not be considered an independent exercise from the first edition since users of the Principles would benefit from a unified document.

31. Bonell pointed out that this had been the understanding of the Governing Council which had always spoken of a “second enlarged edition”.

32. Fontaine remarked that in civil law systems some of the proposed subjects formed part of contract law while others belonged to the general law of obligations, but did not believe this should deter the Working Group from considering the topics. The existing chapter on performance addressed issues relating to the law of obligations such as the time and place of performance. Issues relevant to a more general application had been considered in the context of contract law and this was a useful exercise.

(a) Agency

33. Bonell stated that agency had been suggested for inclusion for a number of reasons: the importance of the subject *per se*, the existence of the 1983 UNIDROIT Geneva Convention on Agency in the International Sale of Goods which, although not yet in force, was the result of many years’ work and was a remarkable example of applied comparative law. In addition, the “Principles of European Contract Law” also contained a chapter on agency which was largely based on the Geneva Convention.

34. Jauffret- Spinosi indicated that in France agency was a special contract and wondered whether this was the case in other countries.

35. Bonell agreed that a number of civil law systems refer to agency as “*contrat du mandat*” or “*Bevollmachtigungsvertrag*”, and common law systems likewise usually speak of agency in terms of a contractual relationship.

36. According to Furmston in common law systems agency formed part of the law of contract and was itself a special contract. The internal aspect of the relationship was a special contract and the extent to which the activities of the agent brought the principal into a contract with a third party form part of the law of contract generally. He added that he believed there were very few international commercial contracts which did not involve the use of agents by one side or the other if not by both, making agency an issue of central and practical concern.

37. Di Majo suggested that the topic under consideration would be better called “representation” as in civil law countries agency was a special contract.

38. Bonell expressed doubt that the term “representation” had much significance for a common lawyer. Throughout the preparatory work for the Geneva Convention terminology had been one of the most controversial issues. The German term “*Vertretung*”, which Di Majo apparently had in mind when he suggested the term “representation”, was not necessarily synonymous with the English term “agency”. He urged the Working Group to turn to the substance of the topic and drew its attention to paragraph 22 of Doc. 55 essentially focussed on the external aspect of agency.

39. Finn indicated that it was only when one got to point 3 on the list in the study that one began to consider the agent’s actions vis à vis the principal and third parties. He was not sure whether the intention was to deal with the agent/principal relationship or the acts of the agent insofar as they had a bearing on the principal/third party relationship. If the relevant contract was the one between the principal and the third party, then the law of agency as such was only relevant to the extent that it affected that relationship.

40. Bonell drew attention to Article 1 of the Geneva Convention which provided that “this Convention applies where one person, the agent, has authority or purports to have authority on behalf of another person, the principal, to conclude a contract with a third party. It governs not only the conclusion of such a contract by the agent but also any act undertaken by him for he purpose of concluding the contract or in relation to its performance and it is concerned only with relations between the principal and the agent on the one hand, and the third party on the other.” Significantly, the chapter on agency of the European Principles, which was largely inspired by that Convention, bears the title “Authority of agent”. The reason for such a title could well be the concern already addressed regarding the ambiguity of the term “agency”. Maybe it was too early to decide on the title of the chapter but the Group should in any case determine the scope of the chapter and wondered whether it could accept the approach taken in Article 1 of the Geneva Convention.

41. Finn explained that in his view it was a question of balance. Did one define the internal characteristics of the relationship as the predominant concern or only to the extent that they had some bearing on the dealing with the third party? According to him the Principles should also deal with actions of agents which affected the validity of the contract vis à vis the third party. Thus in common law systems conflict of interests could have effects on the validity of the resultant contract, bribery being an extreme example.

42. Schlechtriem agreed that the Rapporteur should consider the question of conflict of interest.

43. Bonell commented that it was interesting that this issue had been considered as forming part of the “external relationship”, while throughout the preparatory work for the Geneva Convention it had been strongly felt that it was a matter much more closely concerned with the internal relationship and which should, therefore, be excluded from the scope of the Convention.

44. Fontaine agreed with the approach adopted by the Geneva Convention. The contractual relationship between the agent and the principal was a special contract referred to with different names and definitions in different legal systems and should not be dealt with. The rest, that is the relationship between the principal, the agent and the third party was a basic phenomenon of the law of obligations and was of great practical use in international contracts and, although complicated, should be included in the Principles.

45. Farnsworth recalled that after the conclusions of the Geneva Convention it had been suggested in the Governing Council that something be done with respect to the internal relationship. The results of a study that was carried out were extremely discouraging and there had never been much enthusiasm for going beyond the limits of the Geneva Convention and of the European Principles.

46. Bonell agreed, explaining that for decades the Institute’s attempts to unify rules on agency, including the internal relationship, had been a disaster. A conference held in Bucharest in 1978 had failed to approve a text because of the many great differences between domestic systems. Even the identification of the contractual relationship in question had proved problematic, since concepts such as “contract of agency”, “commission agency” or “commercial agency” were either unknown in some legal systems and/or have different meanings. Moreover as the scope of the Principles was confined to general contract law, there were also reasons of a systematic nature for not dealing with special types of contracts.

47. Huang was of the view that agency was a very important and useful topic. In China agency posed problems because direct agency was the only type of agency recognised by the general principles of civil law but international trade commercial transactions commonly relied upon what was known as the foreign trade agency system, i.e. the relationship between special trade organisations in charge of import and export

acting on behalf of domestic distributors and consumers, which was normally considered to be outside the scope of normal agency law. According to Huang the UNIDROIT Principles, by adopting general rules capable of being applied to both situations, could assist the Chinese legislators to modify its domestic rules.

48. Bonell then drew the Working Group's attention to Article 1 of the Geneva Convention according to which it applied "where one person, the agent, has authority or purports to have authority *on behalf* of another person, the principal." This provision reflected the unitarian approach which was the result of years of discussion between civil lawyers and common lawyers. Traditionally civil law systems drew a sharp distinction between a "direct" agent, i.e. an agent acting in the name and on behalf of the principal and an "indirect" agent, i.e. an agent acting on behalf of the principal but in its own name. Since the European Principles have reintroduced the concepts of direct and indirect representation, he wondered what the opinions of the Group were in this respect.

49. Uchida asked whether the chapter on agency was intended to cover the following situation: A concluded a contract with a third party in the name of B, but not as B's agent, pretending to be B. He explained that in Japan there were many situations in which individuals acted on behalf of the principal without disclosing that they were agents. In these cases, the third party was not aware that it was not dealing with the person which whom it thought it had contracted. Uchida was of the view that the "pretence" cases should be treated in the same way as agency.

50. Schlechtriem stated that he was aware of the problem and believed it should at least be addressed in the comment. If one appeared under the name of someone else, either he had authority, in which case it did not matter, or did not have authority in which case he should be treated as an agent without authority. A further scenario could be added: if one acted as a presumed agent for a non-existing person, he should be himself bound.

51. Bonell was not sure that the two speakers was discussing the same situation. One situation was where one person presented himself to another as Signor Rossi, knowing that this was the only way the other would be induced to conclude the contract as he would not conclude the contract on the same terms if the other party was not Rossi. In Bonell's view this was a case of fraud which had nothing to do with agency. Another situation was where one purported to be Signor Rossi's agent and signed on his behalf and the third person believed that it was dealing with Rossi's agent. This, on the contrary, fell within the scope of agency as defined in Article 1 ("who has authority or purports to have authority").

52. Uchida agreed that the scenario he had described was a case of fraud and not of agency, but added that, nevertheless, in some cases the contract should be upheld, for example when the person who had been impersonated had had some contact with the

third party and the latter had good reason to believe he was dealing with the person in question.

53. Bonell inquired whether this was not a case of apparent authority based on the principal's behaviour. However, if one was impersonating another person, in what circumstances should the latter be involved?

54. Schlechtriem suggested that in such a scenario the person being impersonated could be allowed to reap the benefit of the contract by ratification. He added that this was a very specialised scenario which should be discussed at a later stage.

55. Uchida explained that he had raised the issue because he was involved in the drafting of the electronic commerce laws in UNCITRAL and the scenario he had described occurred frequently in electronic commerce and it had been suggested that the rules of apparent authority should apply to this scenario.

56. Returning to the issue of direct and indirect representation, Lando explained that the issue had been reintroduced in the European Principles because it had emerged in the discussions that the problems arising under the civil law concept of commission agency and under the common law concept of undisclosed agency were very similar. He confessed however that he had been reluctant to re-introduce the distinction and would be happy to have it deleted from the UNIDROIT Principles.

57. Bonell indicated that no formal decision on the inclusion of the distinction needed to be made at the present moment. He clarified that he did not have any problem with the rules found in European Principle 3.3 as the same rules were an essential part of the Geneva Convention in Article 13(2). And it was essential to have such a measure. What he was more hesitant about was the reintroduction in the Principles and, therefore, at an international level, of the civil law concept of an agent acting in the name of a principal as opposed to acting on behalf of a principal, a concept unknown to common lawyers.

58. Farnsworth stated that his preference was to stay with the Geneva Convention approach.

59. Di Majo too felt that the Geneva Convention approach was the more realistic, as it avoided the problem of *contemplatio domini* which had caused many problems in domestic systems. When the two parties were aware that the agent is acting as an agent there was no difficulty in binding the principal and the third party. The concept did not have any practical usefulness and was more of a cultural practice.

60. Bonell concluded that there appeared to be general support for the Geneva Convention approach.

61. Raising another policy issue Bonell wondered whether the Group saw any difficulty in dealing with agency in view of the fact that the Principles are not a binding instrument and could give rise to problems with respect to third parties, be they third parties vis à vis the agent or the principal.

62. Lando saw no problems in this respect. The Principles were used not only when accepted by the parties but also by judges to fill *lacunae* in the otherwise applicable law. He did, however, see difficulties, possibly not insurmountable ones, as concerned directors' authority because this was an area where the Principles came up against mandatory laws that would be hard to change. The laws on directors' authority in common and civil law systems were very different.

63. According to Komarov, on the contrary, the scope of application of the rules should be limited from the outset to the contracting parties only. If nothing was stated and it was implied that the Principles were binding on third parties this could be damaging to the exercise. Almost all provisions in national laws concerning agency were quasi mandatory as they were usually not agreed upon by the parties and, therefore, had a residual nature. It was very rare for the parties to agree upon the authority of an agent. It would, therefore, be safer to limit the provisions of the agency chapter to the relationship between the contractual parties.

64. Fontaine believed that if provisions on the authority of agents were included, explanations and limitations should be provided in the comments and not in the text. Not only did the Principles already expressly provide that they could not prevent the application of mandatory rules, but the Principles had many other uses over and above the situation where they had been chosen as the applicable law. The points raised should not prevent the inclusion of a chapter on the law of agency, it was just necessary to set limits to the exercise.

65. Finally Bonell invited comments on the idea of dealing in the envisaged section on agency with types of agency expressly excluded from the 1983 Geneva Convention, but of particular importance in international trade practice, such as the authority of those acting on behalf of a company (board of directors, managing director, executive officer, etc.) to bind their company vis-à-vis third parties. The problem has been dealt with in EEC Council Directive No. 68/151 of 9 March 1968 which has been implemented in all Member States of the European Union, and could represent a useful source of inspiration for the envisaged provision on this issue in the UNIDROIT Principles.

66. Finn pointed out that if the Working Group intended to deal specifically with the situation of companies and company directors it might also want to address the position of the authority of government officers and agents in view of their increasing commercial activities. To the extent that a government acted through State-owned corporations, with suitable qualifications the principles applied to directors may be also applicable to state-owned corporations.

67. Bonell pointed out that the issue of whether special rules should apply to contracts when State-owned corporations were involved had been raised before the courts in Italy on numerous occasions and validly concluded contracts had been declared invalid merely because the State-owned company had not obtained the required ministerial authorisations. One may assume that such a requirement should not be relevant vis à vis a third party, particularly when foreign.

68. Schlechtriem suggested that a special provision be included in the chapter stating that the provisions on authority of agents applied to company directors unless the domestic law contained some mandatory rules in this area.

69. Bonell wondered whether one could not go further and envisage including special substantive rules dealing with the matter, inspired by for example the EC directive which had introduced a certain uniformity throughout Europe.

70. Schlechtriem pointed out that the granting of authority to directors, its scope and duration, etc. depended on the memorandum of the company and on the relevant domestic company law. Such rules could not, in his view, be overruled by a general provision in the Principles.

71. Furmston inquired whether Schlechtriem was referring to the scenario where, for example, a provision of German company law provided that the authority of directors ended before they ceased being directors. Schlechtriem replied that he was referring to the converse situation, namely, where the authority continued even once they had been dismissed from their position. Furmston stated that common lawyers were familiar with such a situation. He wondered whether Schlechtriem meant that if there were restrictions on the authority of directors in a company's articles of association, people dealing with the company were expected to know whether the directors had complied with them. Schlechtriem answered that mandatory rules of domestic company law dealing with directors' authority could not be derogated from, while restrictions to their authority applied only in the internal relationship between the directors and the company. Furmston asked whether such mandatory rules could, for example, prohibit directors from selling the company. Schlechtriem replied that that was a restriction in the law: directors could not amend the charter of the company.

72. Bonell wondered whether Furmston was referring to the special difficulties common lawyers traditionally face on account of the *ultra vires* doctrine. Furmston stated that this doctrine had nothing to do with authority of agents: it prevented companies, and not directors, from doing certain things. The case he had in mind was *Royal British Bank v Turquand*. In that case the director's powers had been limited by the company's articles, which provided that directors could not do certain things unless they had a certain majority. The question arose whether people who dealt with the company needed to inquire whether the internal procedural rules had been complied with. There were two separate doctrines in England. One was the *ultra vires* doctrine which had been rightly abolished. A separate doctrine dealt with the question of whether

companies were bound by acts of directors when the directors had not complied with internal mechanisms. In many cases in the nineteenth century people had managed to avoid contracts on the ground that the procedures as laid down had not been complied with. The modern view was that directors should be treated in the same way as any other agents, the relevant issue being whether the third party reasonably relied on the directors having the authority. There was therefore no special rule of directors. According to Furmston if it was decided that the Principles should have a special rule for directors he would accept this but he felt the discussions should not start out assuming that there should be special rules for directors.

73. Bonell drew the Group's attention to Section 35A of the Companies Act 1989 which provided special rules as to the (ir)relevance of limitations of the authority of the directors under the company's constitution. More or less the same rules had been adopted throughout Europe after the 1968 directive. He wondered whether it was not advisable to adopt a similar approach at an international level as in some legal systems it might still be possible to challenge the validity of a contract with a third party on the ground of limitations to the directors' authority under the company's memorandum.

74. Schlechtreim insisted on including a reservation clause stating that the rules on the authority of agents applied to company directors unless special mandatory domestic provisions existed. He added that it was the law of the domicile of the company which would determine the authority of directors.

75. Lando pointed out that different conflict of law rules existed as to which law governed the authority of directors. In some states it would be that of the domicile of the company whilst in others it could be the proper law of the contract. He inquired what additional benefit would be derived by including rules on the authority of directors in the proposed rule which did not already exist in the European directive.

76. Schlechtriem replied that the company law directive did not cover the situation where the director acted outside his or her authority and was, therefore, personally liable.

77. Jauffret-Spinosi supported the idea of dealing with the authority of company directors, although in European Community Member States the matter was already covered by the second companies directive.

78. Finn pointed out that in common law countries a director was not considered an agent of a company, but was merely a vote.

79. Bonell recalled that traditionally at least the question of directors' authority was considered as falling outside the scope of the general rules on agency. A different issue was that of "officers" who were agents as they did not bind the company by virtue of company law or its memorandum but by virtue of a special authority conferred on

them by the board of directors. He wondered to what extent the envisaged chapter on agency would apply in this case.

80. Finn explained that in Australia a member of the board of directors had no authority as an individual to contract on behalf of the company. Before he or she could do so he or she required the authority of the company. A director could, however, vote as a member of the board, on a contract in which case he or she was not acting as an agent but merely as a vote in an organ that acted on behalf of the company.

81. Bonell pointed out that a distinction had to be drawn between the internal decision-making process in a company and its external acts vis à vis third parties. The former was outside the scope of the Principles while the latter could fall within the Principles. Normally, while it was the board, and not a single director, that took decisions within the company, it was one or more specific persons who acted vis à vis third parties and the question was whether they had authority to do so and to what extent internal limitations could be invoked against third parties.

82. Schlechtriem thanked Bonell for clearing the confusion and pointing out that the issue in question was that of authority. In respect of companies this could be the authority of an agent or of the board of directors. It was only in respect of the latter that special rules could exist in domestic law.

83. Furmston referred to the leading English case on the subject, where Lord Diplock had held that a person who had been held out by a company as being its managing director had bound the company even though he was not even a member of the board. Contracts made by companies were to be treated in the same way as all other contract: it was a question of the apparent authority of the person.

84. Bonell pointed out that the case did not involve any internal restrictions but cases could arise when a member of the board signs a contract and the company later invoked a rule of its articles providing, for example, that a single member of the company could not bind the company. He referred to Article 35A(1) of the Companies Act 1989 which provided that “in favour of a person dealing with a company in good faith, the power of the board of directors to bind the company, or authorise others to do so, shall be deemed to be free of any limitation under the company’s constitution”.

85. Farnsworth reiterated Finn’s point that if an individual dealt with a single member of the board of directors *qua* member of board of directors that person probably did not have the authority to bind the company and the individual took the risk that there was no authority.

86. Finn pointed out that a director could not give him or herself the authority to act as an agent and his or her representation that he or she was a director of the company similarly did not render the persona an agent of the company. Where such a person was not held out by the company as being an agent, anyone dealing with him or her runs the

risk. The apparent authority of any one director was dependent on his or her position. Generally, non-executive directors had very little apparent authority.

87. Furmston concluded that, in his view, the common law did not require special rules to deal with directors' authority.

88. Bonell inquired, if that was the position in common law countries, why it had been considered necessary to expressly state in Article 4 of the Geneva Convention that for the purposes of that instrument "an organ, officer or partner of a corporation, partnership or other entity, whether or not possessing legal personality, shall not be regarded as the agent of that entity[...]" thereby excluding from the agency rules everything related to companies and associations.

89. The Group decided that the topic of agency should be given priority and appointed Bonell as Rapporteur.

(b) *Limitation of actions*

90. Opening the discussion on limitation of actions as a possible new topic to be included in the second edition of the Principles, Bonell first of all wondered whether the fact that this topic was normally regulated at domestic level by mandatory rules was considered to be a problem on account of the non-binding nature of the Principles.

91. Fontaine felt it was not. After all, in Belgium it was not clear whether the rules on extinctive prescription were mandatory or not. For example, the prescription period could not be lengthened but could be shortened; prescription could not be waived in advance but could be once the period had expired, and judges could not raise prescription *ex officio*. There was, thus, a wide margin of freedom of contract. He felt there was scope for very useful rules, addressing *inter alia*, the causes for interruption or suspension of prescription.

92. El Kholy commented that, as parties were free to chose the governing law of the contract, if they chose the Principles they were outside the scope of any domestic law and then there would not be any problem with mandatory rules of domestic law.

93. Furmston explained that in English law historically prescription was considered a procedural matter governed by the *lex forum*, but conflict of law rules could operate so as to give rise to situations where there were no rules governing prescription. However if the Principles were the chosen law in an international arbitration, there currently was a gap in the system as no prescription rules existed.

94. Farnsworth, recalling the UNCITRAL Convention on the Limitation Period in International Sale of Goods in force among some 20 States, recommended that

envisaged rules in the Principles on prescription should depart from it only if there were very convincing reasons.

95. Finn inquired whether it was possible to postulate a simple limitation period for commercial contracts generally, given their range, as it was for sales contracts.

96. Schlechtriem agreed that one of the most important questions to be addressed was whether uniform periods of limitation should be adopted, in which case it was wise to adopt the four year period used in the UNCITRAL Convention, or whether it was preferable to adopt another period, as four years was too short a period for certain types of contract, such as international construction contracts. A related question was when the time began to run: this could start to run when the goods were handed over, in which case four years may be too harsh in construction contracts. Or, alternatively prescription could start to run from the time when the recipient knew or should have known of the defect, in which case four years would be acceptable.

97. El Kholy pointed out that in Arab countries applying Islamic law strictly the concept of prescription did not exist as the concept of a right being lost merely by the passing of time was considered immoral. However other Arab countries accepted the concept. Yet even the former recognised the concept of non-audition of an action, i.e. judges being prevented from hearing actions after three years, notwithstanding the fact that the underlying right remained intact.

98. Schlechtriem thought that this was a question of how the rules on running of the period of limitations worked. If it was considered a defence which could be raised, leaving the right intact, there would not be any problems as, for example, the debtor could pay after the period had elapsed, so the right was not extinguished. He believed this was something that should be considered during the discussion of the effects of prescription.

99. Bonell remarked that the prevailing view was to consider limitation as a defence and this would avoid problems with the Islamic rules. He then inquired whether the Working Group could envisage the adoption of a single limitation period and of a single starting point for the running of time.

100. Schlechtriem pointed out that the issue of the reasonable length of the limitation period arose not only in relation to construction contracts but also in relation to consulting contracts and contracts for the assessment of the value of companies. He had been rapporteur on prescription for the German Law Reform Commission and after careful consideration he was of the opinion that a single period was acceptable, but that adjustments as concerned the commencement of the prescription should be envisaged so as to avoid that time begins to run before the party concerned has had a chance to pursue the claim. The fact that the Principles only addressed commercial contacts and not tort liability vis à vis consumers made the task easier.

101. Bonell wondered whether the rule according to which the limitation period should not start running until the party knew or ought to have known of the claim, apart from construction contracts where it was absolutely reasonable, also made sense in contracts for the delivery of mass goods.

102. Schlechtriem believed the rule did make sense even with regard to sales contracts and non-conformity of the goods, because there was an obligation on the buyer to examine the goods and the notice period started to run when the buyer could have known of the defects and the same rule could apply to the limitation period. He admitted however that this would be a departure from Article 10(2) of the UNCITRAL Convention.

103. Lando stated that he was in favour of introducing a uniform limitation period. He gave the example of a construction contract where a defect was discovered after 25 years. He suggested that there should be a maximum period of time after which one was absolutely precluded from making a claim.

104. Schlechtriem agreed, suggesting that, in addition to a rather short limitation period which began to run on the date when the non-conformity or breach of contract could have been discovered, there should also be an absolute period of about ten years. This was the approach taken in the product liability directive and the German civil code in regard to tort claims.

105. El Kholly also was in favour of a single limitation period provided that adjustments were made as to the starting time depending on the type of contract in question.

106. Finn drew the Group's attention to Article 3.18 of the Principles and inquired whether the damages referred to therein were considered essentially contractual or delictual in character. In other words, did the Principles deal with delict as well as contract? Bonell stated that the rules on limitations were not intended to cover tort actions. With respect to Article 3.18, different conclusions could be reached on the basis of different domestic rules on the nature of the type of action. In the context of the Principles however the damages in question may be considered broadly speaking contractual in nature and should therefore be covered.

107. Uchida inquired how the limitation period was to be applied in cases of breach of contract giving rise to a right of termination.

108. Schlechtriem was of the view that the period of limitation applied to rights and claims: the right to terminate a contract could be barred by a period of limitation in the same way as a claim for damages. If a contract was terminated, then a separate period of limitation would run for the restitutionary claims thereby created.

109. Furmston gave the example of where one party committed a non-excused non-performance and the limitation period was four years and inquired whether it would be possible for the other party to do nothing for four years and then terminate. In England judges would be of the view that the right to terminate had been waived in such circumstances.

110. Bonell wondered whether under the Principles the right to terminate was subject to a limitation period at all. Article 7.3.2(2) referred to a time restraint which was similar to what in Italian law is known as *decadenza*, or in German law as *Ausschlussfrist*, i.e. a rather short period in which a party must do something in order to avoid forfeiting its right. Termination, as well as avoidance, which did not require any judicial action but merely a timely notice to the other party, in his view fell outside the scope of the envisaged rules on limitation.

111. Fontaine expressed his support for the adoption of a single limitation period with variations of the starting times, but did not believe there should be a range of starting times for different types of contracts and in different circumstances. Three or four different problems, such as validity or non-performance could be identified and different starting times established. He also expressed his support for a maximum period after which no claims could be made.

112. With regard to breach of contract, Schlechtriem pointed out that two situations were non-controversial: non-performance, which was always known by the other party and in respect of which, therefore, the period of limitation could begin to run when the breach occurred (Paragraph 10 of the Limitation when the Convention); and delayed performance which was likewise immediately known to the other party. The only critical case was that of non-conformity because defects were often difficult to discover. In the discussions within the German Law Commission opponents to the choice as the starting time of the moment when the defects were known or ought to have been known, considered this to be a very uncertain concept which could give rise to litigation. He personally favoured the concept embodied in the Principles with respect to notice requirements. If this approach were adopted it would not be necessary to lay down different starting points for the different types of contracts. In addition, he favoured the adoption of a ten year maximum period of limitation regardless of knowledge.

113. El Kholy favoured the adoption of a period within which the party ought reasonably to have known of the defect, as this was a logical objective standard.

114. Farnsworth expressed surprise at the idea that termination notice could validly be given four years after the breach. He also could not understand the suggestions that the same time limit could be used for issues of validity. There were comments in the existing Principles that provided that in relation to misrepresentation or mistake it was necessary to act promptly. Waiting a number of years could not, in his view, be considered prompt action.

115. Bonell inquired whether the Group was of the view that, within the existing Principles, the right to avoid a contract on grounds of mistake, threat, fraud, gross disparity, was subject to a limitation period. He believed that limitation periods were not applicable, and that prompt action had to be taken or the right of action was lost irrespectively of prescription. In his view, this was also the case for termination. It was, therefore, only in relation to actions for damages and, possibly, requests for specific performance that the prescription rules would apply.

116. Farnsworth explained that at common law it was impossible to wait several years before requesting specific performance. Equitable relief had to be exercised within a time which was not the same as the determined periods of limitation but which was, generally, much shorter.

117. Furmston pointed out that at common law a right to specific performance would be lost long before a right to damages under the same contract. Rules on limitation of action would not be applicable.

118. Schlechtriem explained that the length of the limitation period did not mean that the obligee could remain inactive for years before requesting specific performance. But in regard to ancillary obligations, the obligee might not be aware of the breach, for example in relation to provisions prohibiting the re-importation of goods. Knowledge was necessary for breaches of such terms and it might take some time for the re-import to occur. Passage of time should not be a bar to relief such as injunctions.

119. Di Majo thought it acceptable to have a single starting time for issues of validity of the contract. For other remedies, such as termination or specific performance, the starting time should be the time of the breach and the breach occurred when the party became aware of it. It was possible, however, that the date of damages was different from the date of the breach. It might, therefore, be necessary to have a flexible starting point with respect to breaches and damages.

120. Bonell observed that under the Principles validity was dependent on prompt notice and not subject to periods of limitation. The same applied to termination.

121. Farnsworth observed that problems only arose in relation to specific performance, as this was an equitable remedy and as such was very flexible and not amenable to being phrased in black letter rules. Although specific performance could be addressed, common lawyers would be surprised by the setting of any time limit for this remedy.

122. Finn added that equitable remedies such as specific performance, injunctions, specific delivery, avoidance, were all subject to the same principles which required their exercise in a timely manner. The idea that anyone could stand by with notice in respect of any of these remedies was a complete anathema to the common law system.

123. Schlechtriem considered such requirements to be limitations intrinsic to the remedy of specific performance, not at all affected by a period of limitation which civil lawyers may regard as applicable to the remedy of specific performance.

124. Bonell pointed out that under the present edition of the Principles it was not clear whether the remedy of specific performance was subject to a limitation period.

125. According to Schlechtriem the Principles already required requests for specific performance to be lodged in a timely fashion once the party became aware of the breach, therefore there already was a cut off date in rule 7.2.2(e). this was the same as for termination and avoidance. Bonell objected pointing out that this was a case where it was impossible to require specific performance.

126. Farnsworth thought that no common lawyer would object to a rule stating that it was not possible to request specific performance four years after the breach if it was clear that that would never be applicable in practice because the remedy would always be cut off sooner. It would, however, be misleading to say that there was a four year period of limitation for specific performance in that case.

127. Lando gave the scenario of A having a right to specific performance against B. If specific performance were claimed in due time but not pursued, the limitation period would begin to run as notice had been given and the requirement in 7.2.2(e) had been satisfied. If nothing further was done in the next four years, specific performance could no longer be sought.

128. Farnsworth did not believe the issue was resolved by rule 7.2.2 because common lawyers would read the word “require” as meaning “go before a court” while Comment (e) to 7.2.2 defined “request within a reasonable time” as “fail to demand performance within a reasonable time” and common lawyers would not understand such wording as requiring the party to go to court. This was something that should be clarified when the text of the Principles on performance was reviewed.

129. Schlechtriem thought that there were additional requirements for all kinds of remedies be they damages, avoidance or specific performance. Often the remedy was cut off before the lapse of the limitation period. He suggested that a rule could be drafted which did not refer to specific remedies. Damages, and if accepted, price reduction would fall within the scope of the rules on limitation periods.

130. Finn agreed with the suggested approach. If a limitation period merely meant that no claim could be made it was not necessary to identify the form of claim. This was the way statutes of limitation were drafted in common law systems and this did not give rise to any problems with equitable remedies. It was just the longstop, providing that no claim could be brought after that time period had elapsed.

131. Bonell thought this was a very useful suggestion but believed that the problem of 7.2.2(e) still remained.

132. Huang inquired whether, if a four year limitation period was adopted, this would be a mandatory rule or whether the parties retained the power to fix a shorter or longer period. She also inquired whether the rules on limitation of actions only governed the claim or whether they also applied to the right to request termination of contract. Under Chinese law if a contract was concluded in a situation of gross disparity the weaker party had the right to request termination within one year.

133. Bonell replied that the limitation period was a question of substantive law and as such could be dealt with in the Principles. Therefore, if the Principles were chosen as the applicable law of a contract the provisions on limitation periods would apply. Nevertheless, a Chinese court may, encouraged by rule 1.4, still apply its own domestic rules on limitation. With regard to the parties' power to derogate, the issue should be covered in one way or another. The period only related to claims while the right to terminate by notice was subject to existing rules.

134. Returning to Farnsworth's comments on the ambiguous language in 7.2.2, Fontaine observed that the term "required" was defined in the Comment to 7.2.1 where it was stated that "the term 'require' is used in this article to cover both the demand addressed to the other party and the enforcement, whenever necessary, of such a demand by a court".

135. Finn reported that there was a growing tendency in legislation on limitation periods in Australia, principally in relation to tort actions but increasingly also for contracts, to provide for a limitation period with a qualification that actions could be commenced in such further time as the court considered fair and reasonable in the circumstances. He thought that as the Group was trying to anticipate a wide range of contingencies, rather than attempt to formulate an exhaustive list of special circumstances, consideration could be given to including in the Principle a residual category of cases which admitted the possibility of an extension of time to be granted by a court or arbitrator to take account of contingencies unforeseeable in advance. This could be tied explicitly to Article 1.7 as there could be circumstances in which fair dealing could allow some flexibility in the application of limitation periods.

136. Schlechtriem observed that a similar "escape provision" had been considered by the German Law Reform Commission which however had discarded it as it was considered that this would grant to the courts too much discretion and give rise to unpredictability. However, a similar result could be achieved by estopping, in certain circumstances, parties from relying on limitation. Possibly the general provision on good faith in the Principles could be sufficient to cover the extreme cases so that there would be no real need to include an escape provision in the chapter on limitation.

137. Fontaine found it difficult to accept the suggestion inasmuch as the aim of prescription was to bring about certainty and *paix judiciaire* after a certain period of time. He thought it would be interesting to see some examples of legislation that took this approach.

138. Furmston added that there had been numerous attempts to reform this area of the law in England, none entirely successful. One of the first attempts gave the courts a discretionary power to extend limitation periods and this had caused more difficulties than it had solved. A more recent attempt established two periods: the standard period running from the breach of contract, followed by an additional period running from the date of discovery or reasonable discovery. He believed that many practical problems would arise when the Group turned to the practical implications of the suggested rule. For example, it would be necessary to define precisely what a party would have to do within the limitation period not to lose the action. In English law it was necessary to issue the writ. Once this had been done, the litigant needed not take any action for the next six months. He foresaw difficulties in practice where arbitration proceedings had been commenced within the limitation period and the plaintiff wished to amend the pleadings.

139. Schlechtriem referred to Article 13 of the Limitation Convention which provided that the “creditor performed any act which under the law of the court where the proceedings are instituted is recognised as commencing judicial proceedings”, and felt that it was not possible to be more specific.

140. Schlechtriem then pointed out that there was a connection between the approach taken as to the time when the prescription period started to run and the need to include a residual catch-all provision. If the view was taken that the period would begin with knowledge or reasonable knowledge of the right of action, the parties could be entrusted with finding an acceptable solution in the remaining cases. If, on the other hand, the starting time adopted was the time of delivery of the goods or of the completion of the construction, such an escape route would be much more necessary.

141. With regard to the last point, Lando recalled that the European Commission had strongly opposed the inclusion of such a catch-all provision. In his view such a rule would only be useful when the defaulting party involved the other party in negotiations and prevented it from commencing proceedings until after the limitation period had expired.

142. El Kholy thought that it would be extremely difficult and possibly dangerous to have a rule providing that negotiations would prevent prescription from running. In his view, it was always open to a party to take the necessary action to preserve its right and then negotiate. The mere act of negotiating should not, of itself, prevent time from running.

143. Schlechtriem pointed out that in German law there was a rule according to which the running of the limitation period was suspended during serious negotiations. The rule, which had been successfully applied by the courts, concerned construction and sales contracts. The suggested approach of suing and then negotiating had been considered non-conducive to serious negotiations.

144. Fontaine stated that in the Benelux countries in the context of insurance contracts negotiations had been allowed to interrupt limitation periods and the question of what constituted negotiations had arisen before the courts. The position of the insured parties had been greatly improved as prescription was interrupted merely by giving notice of the loss.

145. Farnsworth was troubled by the prospect of defining “serious negotiations” in the context of international arbitration on account of the different legal traditions and cultures. Furthermore, he believed that the commencement of arbitration was often conducive to settlement.

146. According to El Kholy one way of solving the impasse would be to hold that negotiations did not suspend the running of time but the parties could expressly agree that time did not start running because of the negotiations. If a party refused to accept that negotiations suspended the running of time this could be interpreted as an indication of bad faith.

147. Farnsworth pointed out that Article 22(2) of the Limitation Convention provided that “the debtor may at any time during the running of the limitation period extend the period by a declaration in writing to the creditor.” This would permit the envisaged kind of agreement and eliminated the difficulties of defining serious negotiations in the comment.

148. Schlechtriem supported this approach and pointed out that the possibility of estoppel remained if a party, under the pretext of negotiations tried to let the period of limitation run out. This was preferable to a specific rule providing that negotiations suspended the running of time. Serious negotiations would be considered to be underway when one party sent the other a letter suggesting discussions. Only if the other party accepted the request would there be a suspension of the limitation period. He suggested that if the limitation period were set at four years running from knowledge or possible knowledge this would be a rather lengthy period. The rule on suspension for negotiations was included in the context of a shorter limitation period so the rule might not be necessary.

149. Lando pointed out that if the rule allowed the parties to shorten the limitation period by agreement the issue could nevertheless arise.

150. Komarov proposed that the restoration of the period of limitation should also be addressed. This was not interruption or suspension. In Russia, when the

limitation period had elapsed courts could determine whether there existed special circumstances justifying the restoration of the period. For example, there had been a recent case where the plaintiff had requested that the limitation period be restored on the ground that it had not brought an action within the limitation period as it had been involved in negotiations with the defendant and the court had started the limitation period anew.

151. Bonell pointed out that this result could be achieved by granting tribunals a special power to entertain actions after the expiry of the limitation period as suggested by Finn, or by considering the negotiations as having suspended the running of time.

152. Di Majo suggested that consideration should also be given to the possibility of a court restoring the limitation period in cases where a party exercised utmost diligence, as was possible in copyright litigation in Italy.

153. Bonell pointed out that this was very similar to the suggestions made by Finn and Komarov which had not been met with much enthusiasm. He then pointed out that there were other generally accepted grounds for interruption, still to be considered, such as force majeure. In addition it had still to be decided whether the effect of the expiry of limitation periods was the loss of the right as such or just the loss of a defence. In his view the second alternative found more support at the comparative level.

154. El Kholy explained that the difference between non-audition of the action in Islamic countries and prescription was that the right itself was not lost, so that if it was admitted by the party in default, it once again became enforceable. In other systems the right was lost and all that remained was the *obligation naturelle*. He wondered if there was a way of reconciling the two approaches.

155. Schlechtriem stated that limitation was a defence which left the right intact but made it unenforceable. Reinstatement was a different matter and he wondered whether in common law systems reinstatement of the claim by waiver of the defence required consideration.

156. Furmston replied that in the past legislation had provided for that possibility but the most recent legislation had removed it. But there was a time when claims could have been revived by acknowledgement and that was one of the recognised exceptions to the doctrine of consideration.

157. Before closing the discussion on limitation Bonell called for comments on the question of the mandatory or non-mandatory nature of the rules on limitation.

158. Komarov stated that under Russian law all rules on limitation periods were mandatory. There was an emerging tendency, however, to distinguish between absolutely mandatory rules and relatively mandatory rules, and in this connection he referred to Article 1.4 which, in his view, concerned absolutely mandatory rules. For

example, if foreign law were chosen as the law of the contract some of the domestic rules, such as those on limitation, would be excluded since they were not absolutely mandatory.

159. Bonell agreed, adding that this had been recognised in the UNCITRAL Convention which expressly provided that the parties could exclude the application of the Convention altogether, thereby confirming that States did not consider that Convention to be absolutely or internationally mandatory.

160. El Kholy considered that the related topic of *déchéance* should be addressed. Under Egyptian law it was impossible to shorten limitation periods but it was possible to have forfeiture upon 24 hours notice by agreement: contractual forfeiture or *déchéance contractuelle*. He considered this paradoxical and believed that the Group should consider the issue.

161. The Group decided that the topic of limitation of actions should be given priority and appointed Schlechtriem as Rapporteur.

(c) *Assignment of contractual rights and duties*

162. Bonell opened the discussions by identifying the three principal issues which arose within the topic: assignment of rights *strictu sensu*, assignment of debts or assumption of debt and assignment or transfer of contracts, meaning the transfer of all the rights and duties arising under a contract. Possible models, in addition to domestic law, were the 1988 UNIDROIT Convention on International Factoring which addressed some of the problems relating to assignment of rights in connection with factoring agreements. Moreover there was the UNCITRAL draft Convention on Assignment of Receivables Financing, which although originally limited to assignment of receivables for financing purposes, in its latest drafts seemed to include virtually all kinds of assignments.

163. Huang wondered whether the terms “assignment” and “transfer” were synonymous. In the new Chinese civil law there was one chapter on modification and transfer of a contract and she wondered whether it should employ the term “assignment”.

164. Farnsworth thought that a transfer of a right was the same thing as an assignment of a right, while the transfer of a duty is usually called “delegation”.

165. Schlechtriem pointed out that in German law the concept of transfer of a right was much wider, including also the property issues and legal assignment. “Transfer” would also include legal assignment while “assignment” meant assignment by agreement of the parties. Transfer was wider and also included, for example, subrogation.

166. Finn stated that at common law assignment was essentially a property notion and given that contractual rights were property it was an appropriate term to use when speaking of assignment of rights because it covered both assignment of real property and, as in the present case, assignment of personal property. Rights in the common law system were property or *choses in action*. When it came to duties, however, the use of the term “assignment” was not appropriate as duties were not property.

167. Jauffret-Spinosi pointed out that French law drew a distinction between *cession* and *transfer*. The term *cession* was used predominantly for *meubles incorporels*, while transfer was used in relation to movable and immovable property. The term “assignment” was preferable.

168. Fontaine observed that terminology was a difficult issue that would have to be agreed. In French there existed the term *cession*, used in connection with *cession de créance* but there was also the wider term *transmission de créance* to cover subrogations and other methods for *transfer de créance*.

169. Bonell thought that before agreeing on terminology the Group ought to decide whether it wanted to consider the topic on the understanding that transfer by operation of law would be excluded.

170. Furmston observed that in English law it was possible for a creditor to assign a debt without the assignee’s participation in the transfer.

171. Lando thought the question as to whether acceptance was needed was a general problem, and related to whether it was possible to transfer a right without the acceptance of the assignee. The European Principles deal with the issue, and Articlele 2.107 states that it is possible to transfer a right without obtaining the consent of the assignee.

172. Schlechtriem believed that two questions had to be addressed. The first concerned terminology and he suggested the Group could agree to call voluntary transfers “assignments” and the Comments could provide an explanation of the various terminologies. With regard to the second issue, namely, whether assignment required acceptance by the assignee, he still believed “assignment” was the preferable term rather than “transfer” which could have additional connotations.

173. El Kholy agreed that “assignment” was more specific and technical and suggested that the term employed be “assignment of rights and of obligations”. “Assignment of debts” could be misunderstood to relate to assignment of rights.

174. According to Schlechtriem one topic was missing from those listed in Doc. 55: the question of whether an assignment required the consent of both parties or whether it could be unilateral. He believed this was the first question that should be considered.

175. Farnsworth suggested in addition to deal with the question as to whether underlying securities were transferred along with the right they secured. In the common law they generally were.

176. Finn observed that at common law only present rights could be voluntarily assigned. A promise to assign was only effective if supported by consideration. There was a sharp distinction at common law between present assignments and promises to assign.

177. According to Schlechtriem unilateral promises and unilateral transfers of a right could not be put on the same footing. The promise could give rise to an obligation but it was still up to the promisee to decide whether to take advantage of it. If a right could be assigned without the assignee's consent, the assignee might not be aware of the right. He wondered whether as a matter of policy it was advisable to permit someone to enrich someone else without the latter's consent.

178. Furmston thought that this was an area where the common law had well defined concepts: it drew a sharp distinction between property and contract transactions. In the former, which related to existing rights, it was sufficient for the relevant formalities for the transfer of the right to be complied with and which, as concerned contractual rights, were very simple. The position is different with regard to something that does not yet exist. For example, if one wrote a book, the copyright could be transferred by one method but if a contract was concluded to write a book the copyright could not be transferred as it did not exist yet, so the obligations could only be in contract.

179. According to Farnsworth several separate questions arose. He believed that the basic principle should be that one could not give someone else a white elephant and expect that person to pay the taxes on it and feed it if that person did not want it. In the United States the rules on this matter were in accordance with the European Principles, namely that it was incumbent on the recipient to refuse the gift rather than on the donor to inquire whether the recipient accepted the gift. It was merely an issue of where the burden lay.

180. Bonell still saw some confusion. What should be discussed first was whether the assignment of an existing right required the assignee's consent. A second issue was the promise to assign and he suggested this should be dealt with at a later stage. The third issue was the question of the assignment of future rights which should This was something that should be immediately addressed given its importance in commercial practice.

181. Fontaine agreed that promises to assign were not a priority whereas future rights should be addressed. In relation to the question of the assignee's consent, he pointed out that normally an assignment of rights took the form of an agreement between the assignor and the assignee and that situations where an assignment was

made without the consent of the assignee were very rare. He thought that the real issue was whether in the case of transfer of rights the consent of the debtor was necessary and he believed it was not, while in the case of transfer of duties the creditor's consent was very important.

182. Bonell suggested that the Group focus on the requirements of the assignment to be effective vis à vis the assignor's creditors, vis à vis the debtor and, possibly, vis à vis subsequent assignees, while leaving aside for the time being promises to assign.

183. Finn pointed out that at common law the transfer could be effective in equity before it was effective at law and this related to the priority questions, there then was the issue of formalities and of who should carry them out. These were all property questions. There was a variety of ways in the common law system in which someone could be given the benefit of a right; it could be transferred, by the law of property or that person could be made beneficiary under a trust. In the same way that property could be transferred by gift or by contract a present right could be transferred by gift or by contract. The formalities were quite different.

184. Bonell suggested that gifts should not be considered. The UNCITRAL draft Convention adopted the same approach, limiting its scope to assignments given for value.

185. Furmston objected, stating that it did not make sense to draw a sharp distinction between gifts and contracts in this area because in practice, although there might be an underlying contract, the effectiveness of the transaction was dependent on whether the rules on gifts had been complied with. Although it was rare that an assignee would not be informed of the assignment, there may be numerous commercial reasons for which this was not done. The important thing was that the transaction was effective as soon as the formalities had been complied with and although they included informing the debtor, it was not necessary to inform the assignee.

186. Finn added that if an assignment was for value the formalities for the transfer of property were irrelevant.

187. Farnsworth pointed out that such an approach would make it necessary to define "transfers for value".

188. Furmston added that the concept of "consideration" did not form part of the Principles as they currently stood, but the adoption of a concept of "transfers for value" would come very close to introducing it.

189. Fontaine asked how the Factoring Convention and the UNCITRAL draft, both of which considered assignments contracts had been received in common law countries.

190. Farnsworth answered that factoring was a transfer pursuant to an agreement and thought that if the Group wanted to limit its rule to factoring there would not be a problem but if it aimed to address a wider range of assignments, many of these would not be contracts or even based on contracts.

191. Schlechtriem pointed out that the term “contract” was being used in two different ways: first, to mean a contract creating obligations and, secondly, as an agreement to transfer property. He suggested that the two should be kept distinct and that the term should not be used to mean “assignment”. The first issue to be addressed was whether an assignment needed the consent of the assignee and the second was the extent, if any, to which a debtor should be involved or informed of an assignment.

192. With regard to reactions to the Factoring Convention, Finn observed that factoring contracts usually involved receivables which would come into existence at a later date. For them to be assignable at common law there had to be a contract because it was future property. It was, therefore, not surprising that the Convention had been drafted in terms of contract because it was impossible, under property law, to assign voluntarily future property.

193. Lando suggested that the Group should not be concerned with whether the assignment was a contract or whether it concerned property and, instead, focus on the results that it wanted to achieve, leaving aside notions of domestic law.

194. Bonell thought this was a good suggestion but believed that the issue would have to be addressed at some stage, recalling the discussions within the Commission on European Contract Law on the issue of the time from which it was no longer possible for creditors of the assignor to attach the right because it had been transferred to the assignee. He suggested that for the time being the most neutral language possible should be used and that the Group focus on the formal requirements of the assignment between, first, the parties, secondly, vis à vis third parties and thirdly, vis à vis subsequent assignees.

195. Finn explained that the common law distinguished between voluntary assignments and contractual assignments. As concerns the latter which are assignments for value, the transfer of the right to the assignee depends on whether or not consideration has been executed. The requirement of notice to the debtor has the sole purpose of informing the debtor to whom performance has to be made. Until notice was received the debtor could continue to pay the original creditor. After notice, if the debtor paid the original creditor he or she could not set that up as a defence to a claim by the assignee. As far as the assignor’s creditors were concerned it was the time when the property became beneficially that of the assignee which determined whether it formed part of the assignor’s estate for the purposes of any proceedings against the assignor. As these concepts were foreign to the civil lawyers, Finn agreed with Lando that notions of domestic law had to be set aside.

196. Jauffret-Spinosi explained that the French concept of *cession de créance* covered not only money but also the hope of money and was governed by very specific rules. A notification had to be made to the *débiteur cédé*, but it was not necessary to have his or her agreement. In addition, there was *la loi Dailly* of 1981 which permitted the mobilisation of a credit with a bank and which merely required notification, without the need to comply with the formalities relating to *cessions de créance*.

197. Fontaine believed there were several possible technical answers to the question of when the assignment of right became effective. For example, in civil law systems, it would become effective between assignor and assignee at the time of conclusion of the contract. With regard to the debtor it would become effective at the time of notification, while with regard to the assignor's creditors the position was more complicated since clearly notification of them was not practical. As a result assignment was effective vis à vis them either at the same moment as for the debtor, i.e. upon notice but this was not very logical, or at the same time as between the assignor and assignee. This was the position recently adopted by Belgian law.

198. Bonell drew attention to the UNCITRAL draft which had been unable to reach uniform substantive rules on the question of the priority between the assignee and the assignor's creditors, and between several assignees. The special section on competing rights of several assignees in Article 23 provided that "priority among several assignees of the same receivables from the same assignor is governed by the law of the State in which the assignor is located". With regard to competing rights of assignee and insolvency administrator or creditor of assignor the draft provided that "priority between the assignee and the assignor is governed by the law of the State in which the assignor is located". Apparently UNCITRAL had been unable to lay down uniform substantive rules because it had been impossible to settle property issues.

199. Lando considered this approach too pessimistic. In the past there have been other instances where UNCITRAL had been unable to resolve issues which UNIDROIT later addressed successfully such as specific performance. He believed that it would be a defeat to leave the issue to be determined by conflict of laws rules.

200. Farnsworth agreed with Lando. In the United States there was well-established specific legislation governing factoring and receivables which the Principles would not be able to change. However, there were many assignments which did not fall within this category and he suggested that the Group focus on these residual cases. He suggested that the Principles expressly state that they do not affect any existing special legislation on factoring or receivables and if there is such legislation they only apply in residual cases, such as sales of businesses with delegation of duties and assignment of rights.

201. Bonell expressed his concern at the possible exclusion of factoring and receivables. With regard to the latter he was not sure he understood what receivables law actually was, other than the right to be paid a sum of money arising out of a contract

and, consequently, what Farnsworth proposed to exclude from the scope of the Principles.

202. Farnsworth explained that in the United States “receivables” was a bunch of accounts. For the purposes of Article 9 receivables would not include a single assignment in construction contract law.

203. Schlechtriem suggested that it might be necessary to have some form of reservation clause to take into account domestic systems rather than trying to deal with the specialised rules separately.

204. Finn observed that ultimately the property issues would have to be left aside. If a company made an assignment and then went bankrupt, it would be up to local laws of liquidation and bankruptcy to determine the position of the creditors, and he concluded that this should not be dealt with in the Principles.

205. Bonell pointed out that this was the approach adopted in the UNCITRAL draft and wondered whether the Principles could go much further. So far they had dealt with bilateral contractual relationships and had, on a number of occasions, intentionally refrained from addressing the issue of the effects on third parties. If the Group considered dealing in the context of assignment not only as concerned the relationship between the two parties directly involved but also with the effect of the assignment vis à vis creditors, he wondered whether this was not too ambitious since a reference to the Principles in the contract of assignment could hardly bind creditors world-wide.

206. Schlechtriem saw no problem in that connection. Under German law assignments were effected by mere consensus between the two parties and had to be respected by creditors and all third parties.

207. Bonell recalled that in the common law assignment was effective even without consent and wondered what the position of a German creditor of a common law debtor would be, who discovered that the assignment was effective against him or her even without it having to be completed in accordance with the formalities prescribed by German law?

208. Schlechtriem replied that the issue would be decided in accordance with the law applicable to the obligation in question and suggested that any assignment rules in the Principles should apply only to rights and claims arising under the Principles.

209. Lando added that, even if the choice of law approach were taken, there would be difficulties as under some systems the choice of law rules would be those of property law while in others it would be those relating to contracts.

210. Fontaine pointed out that if provisions on assignment were included in the Principles they could be applied by arbitrators and serve as models for legislators. They

would still be useful even if a choice of the Principles as the governing law would not be considered to affect creditors.

211. Furmston thought that the one of the problems discussed concerned the liquidation of the assignor. This would be governed by the local law governing the liquidation. These questions were not discussed in the context of contract law in common law countries. He gave the example of a contractor in severe financial difficulties who made a contract to erect a building at a cost of one million pounds, paid over a period of time. In order to raise cash the constructor assigned the rights under the contract to a bank for £750,000. He wondered whether in some systems the constructor's creditors had rights against the bank or against the person for whom the building was being constructed.

212. Bonell replied that it was possible not only to attach money but also to attach *droits de créance* or claims. The question was from what moment the constructor's creditors would be precluded from attaching its right to be paid.

213. Furmston considered that the right to payment was lost when the constructor received the money from the bank.

214. Bonell pointed out that in the example the constructor had assigned the right to be paid by the purchaser to the bank. Until the constructor had effectively assigned that right to the bank, the right belonged to it and as such could be attached by creditors. The question was from what moment in time the creditors could no longer attach the right because it had been transferred to the bank (the assignee). He thought this was a property issue and as such would not normally be discussed in the context of assignment.

215. Furmston replied that from the time the constructor had concluded a contract with the bank, the bank's interest would rank ahead of everyone else's.

216. Finn thought that it would depend on whether the contract with the bank was an oral or a written contract. If it was in writing, because a right to be paid money was a *chose in action* which could only be assigned in writing, it would be effective from the moment of the contract as this was the only formality which needed to be fulfilled. If the contract was oral, it would not be governed by the law of property but by the law of contract. Once the consideration had been paid by the bank, the assignment would be effective. It could also be effective beforehand, if the contract was regarded as one which was specifically performable.

217. Bonell wondered whether Finn thought common law systems could accept any other solution to the problem. According to Finn any system could be chosen provided that all that only the rights of assignor, assignee and obligor were at issue. On the contrary, once third parties were considered it was not possible to derogate from local law. But it was not pointless to try and develop rules for the first three players as

there would be situations where they would be applicable and insolvency would not arise.

218. Schlechtriem pointed out that the format of the assignment, namely whether it should be in writing or could be merely oral, was an additional issue to be addressed.

219. Recapitulating, Bonell pointed out that in view of the differences existing among the various legal systems it might be advisable not to deal in the envisaged chapter on assignment with the questions of the effectiveness of an assignment vis à vis third parties other than the debtor and of the conflict between several assignees. In support of this approach he referred to the position paper on assignment of rights prepared by Roy Goode for the European Commission in which he stated: “In preparing this outline I have assumed that the chapter will be concerned only with consensual assignments and with relationships between 1) assignor/assignee 2) assignee/debtor and 3) assignor debtor. On this basis I propose to exclude priorities issues arising from a conflict between the claim of the assignee and that third parties etc”. Bonell then raised the question of the relationship between the envisaged rules of the Principles and the Factoring Convention and the UNCITRAL draft Convention on Receivables Financing.

220. Farnsworth suggested that the Group should not feel bound to follow the UNCITRAL model too closely. He distinguished this instrument from the Limitation Convention which had been ratified by some twenty states and which deserved a respect which the draft Convention did not yet warrant. Lando agreed.

221. Farnsworth raised the issue of assignment of contract duties, wondering whether the issue should be addressed by the Group at all.

222. Fontaine explained that the present chapter on performance did not include a topic he thought should have been included and which was relevant to the present discussion, i.e. when a third person could perform in lieu of an obligor. In civil law systems, this was always possible unless the duty to perform was *intuitu personae*. By contrast, common lawyers considered this to be an issue of assignment of duties. In his opinion this was merely a discharge of the duty by a different person at the time of performance and this could not be refused. The problem of assignment of duties occurred before performance was due and in general a new debtor could not be imposed on the creditor without the latter’s consent.

223. Bonell agreed that if the Group decided to address the issue of performance by a third party, this should be done in the performance chapter.

224. Farnsworth pointed out that normally the third party who rendered performance in lieu of the original obligor did not do this voluntarily but at the request of the original obligor. From the common law perspective this was not different from a delegation of duty. The timing issue was in his view irrelevant. He also considered the term “assignment” inappropriate for the transfer of contract duties since if the new

obligor's performance was deficient the original obligor remained liable. Only by means of a novation could that liability be removed.

225. According to Fontaine the term "delegation" was ambiguous. He again insisted on the difference between performance by a third party and assignment of a duty. The latter occurred when, by a certain technique, the third person was not merely someone who agreed with the obligor that he or she would pay at the time payment was due, but instead, became a debtor by taking a pledge that the creditor could claim.

226. According to Farnsworth three questions would have to be addressed in regard to this topic. First, whether the person entitled to receive the performance had to accept performance by the third party. Secondly, whether the person performing in lieu had come under an obligation to render the performance, and thirdly, whether the original obligor was released from the duty.

227. Schlechtriem saw no difference between the common law and civil law positions, provided that the recipient of the performance agreed to the delegation. He thought the term "shifting of debts" should be used for the concept under discussion.

228. Finn observed that all systems tolerated some form of third party performance. What was at issue was the limits of third party performance in a tri-partite situation.

229. Lando pointed out that performance by a third party was contemplated in a special rule in the European Principles. Article 7:206 provides that "(1) Except where the contract requires personal performance the obligee cannot refuse performance by a third person if the third person acts with the assent of the obligor or the third person had a legitimate interest in performance and the obligor has failed to perform it or it is clear that he will not perform at the time performance is due. Performance by the third person in accordance with paragraph (1) discharges the obligor." Lando added that civil lawyers considered the issue completely different from assignment of duties. Yet Bonell recalled that apparently common lawyers did not agree.

230. Fontaine gave the example of a person who owed money and was not going to be present at the time payment was due. A first possibility was to ask the creditor whether it agreed to a change of debtor. The creditor was free to accept or reject the proposal. If the change was accepted, the creditor could either free the original debtor from the obligation or request that the latter remain bound. If, on the other hand, the creditor refused, there would not be an assumption of debt, but the two parties could enter into an agreement between themselves that the third party would pay in June. This agreement would not change anything in the relationship between the creditor and the original debtor and when the third party made the payment the creditor would not be allowed to refuse it. This was payment by a third party.

231. Farnsworth pointed out that both examples were instances of modification.

232. Schlechtriem observed that the difference between performance by a third party and the shifting of debt was apparent in contracts for personal performance where the obligee did not have to accept the alternative services. If there was a shifting of debt and the obligee had agreed to it then there would be no problem and this was what Farnsworth referred to as a modification of the contract.

233. Finn thought that the second example was an instance of novation: the first party dropped out and was replaced under a completely new contract by the third party. There was also the instance when the contracting parties remained the same but performance was carried out by the new third party.

234. Schlechtriem thought there were three situations: firstly, novation, where the original debt was wiped out and completely replaced by a different debt; secondly, transfer of debt, where the first debtor was freed and the second debtor took up exactly the same obligation with the same defences and so on; and, thirdly, the situation where the creditor accepted the third party but did not release the first, in which case there would be two similar debts - joint and severable.

235. Finn felt that Schlechtriem's second example was just a specific form of novation. Schlechtriem replied that in the case of novation certain accessory rights, such as security rights, were abolished or a different period of limitation would apply, while in a case of shifting of debts by releasing the first debtor, all the features of the original debt remained, including accessory and collaterals.

236. Furmston pointed out that the results reached by the civil and common lawyers were not different but that the terminology employed was; and that was giving rise to problems.

237. With regard to the term to be employed to refer to "assignment of contract duties", Fontaine referred to the Australian edition of Fifoot which used the term "assignment of liabilities".

238. Still with regard to the difference between third party performance and assignment of duties, Farnsworth pointed out that in his understanding the issue concerned two types of transactions, both involving three parties. If all parties have agreed to the transaction in question no special problem arose and it was sufficient to mention that in the comments. The situation was different when the parties failed to clarify the precise nature of the transaction, and the black letter rules should be very clear as to what the applicable default rules were in situations where the parties did not expressly state whether the third party was a substitute or an addition and what happened to the security.

239. Komarov wondered whether such rules were intended to cover also the situation where there had been a court judgment giving a debtor the right to payment and this was consensually assigned.

240. According to Schlechtriem the question whether the new creditor could execute a judgment in favour of the previous creditor without the need for a new judgment was essentially a matter of procedural law and as such fell outside the scope of the Principles, while El Kholy, on the other hand, did not consider it a matter of procedure and felt that rights to payment declared by court decisions could be assigned in the same way as rights arising out of contracts.

241. Komarov believed special rules should govern that situation, at least in relation to issues that could have been raised before the court but were not. Schlechtriem believed that the issue of what defences could be raised by an assignee of a debt was a question of *res iudicata* and, as such, outside the scope of rule.

242. Farnsworth thought the discussion should be limited to assignments arising out of contracts in order to avoid difficulties. For example, in the United States some tort malpractice obligations could be transferred and he believed this was not an area which should be addressed by the Principles.

243. Bonell pointed out that in addition to rights sanctioned by court decisions, rights arising from negotiable instruments should also be excluded from the scope of the Principles.

244. El Kholy inquired whether disputed claims fell within the scope of the envisaged rule. If claims which had been confirmed by a court decision were not governed by the Principles it would be odd to let as yet unresolved claims fall within their scope.

245. In reply to Farnsworth's concern, Komarov suggested that the rule could be limited to claims arising out of contractual relationships.

246. Fontaine pointed out that in civil law countries assignment of rights and duties formed part of the general law of obligations and, therefore, applied to contractual rights and claims arising out of torts, but was of the view that the Group should limit itself to claims arising out of contracts.

247. Furmston observed that for historical reasons English law distinguished between assignments of contractual rights and assignment of rights arising out of breaches of contract. If it was a right of action that was assigned the rules were different and much more restrictive. He felt that it was acceptable to have different rules of the two different types of assignment.

248. Fontaine pointed out that the French Civil Code also drew a distinction between disputed and undisputed claims. There was a section on *cession de droits litigieux*, providing that when the claim had been transferred it was possible to recover it by paying reimbursement with interest.

249. Di Majo added that a similar right existed in Italy.

250. El Kholy inquired what approach would be taken towards the very common assignment of rights of action to insurance companies.

251. Schlechtriem stated that different systems had different rules prohibiting assignments for different reasons. In his view, however, all the special rules of domestic systems were already covered by the rule of the Principles providing that matters of immorality and invalidity of contracts were not covered by the Principles but should be left to the domestic law. The Group should not address the numerous specific rules for invalidating particular assignments. Bonell considered this approach commendable.

252. Di Majo raised the question as to the effect of subsequent modification of the contract on assignment. An example would be a construction contract where the price requested had to be increased after the assignment. There were no rules in Italian law dealing with the issue.

253. Fontaine thought that in such a scenario the rights would be transferred as they were at the time of the assignment. If there was an increase of price, the price supplement would only concern the constructor and the client and not the assignee. Bonell pointed out that the position would be different with regard to assignment of future rights and was of the view that the problem depended on the specific terms of the assignment. Jauffret-Spinosi thought this was an instance of *garantie de passif*, when the assignor would be liable for any possible increase in price. Farnsworth observed that there were rules on this question in the United States, but they were default rules. He thought the Principles should have similar default rules on the guarantee or warranty of the assignor.

254. Bonell then called for comments on the question of assignment of contracts as a whole.

255. Schlechtriem noted that the transfer of a whole contract consisted in the transfer of a bundle of rights and duties and before the Group drafted rules on the transfer of the whole bundle, it should, in his view, know how the transfer by shifting of debt was decided. Once rules on assignment of rights and shifting of duties had been laid down, the rules on assignment of the entire contract would be easy to draft.

256. Bonell reported that there was a section in the Italian Civil Code dealing with *cessione dei contratti*. Those rules did not completely coincide with the rules on assignment of rights and duties, so that it was not just a question of extension of the case of assignment of liability. For example, a debtor could not of its own initiative assign the liability to a third party without the consent of the creditor and it was up to the creditor to decide whether or not the assignor was free of the original obligation. If there was an agreement that the whole contract could be assigned then for the assignment of

the single liability, which already may have occurred, special approval was not necessary and the assignor was free.

257. Fontaine explained that this was a subject of some debate in Belgian law. The German approach was the dominant approach; there were no specific rules on assignment of a whole contract but, instead, the rules on assignment of rights and assignment of duties were combined. This was complicated and according to some artificial, because a contract was a connected whole. It had been suggested that a global transfer of contract by an agreement between assignor and the assignee should be the subject of special rules. The Italian and Portuguese civil codes took this approach. Such universal transmission could occur for example in the case of regulated mergers, which provided serious guarantees.

258. Schlechtriem said that there was a European Union directive on transfer of undertakings regulating labour law effects of the transfer but thought this issue should not be addressed by the Principles. Fontaine objected that the European directive only governed the transfer of labour contracts and could be complemented by domestic rules.

259. Uchida raised the example of rented land. In Japan the rule was that when rented land was sold, the tenancy was automatically assigned to the new owner without the needs for the consent of the tenant.

260. Jauffret-Spinosi explained that under French law the consent of the assignor and the assignee were necessary and that there was a difference between *cession du contrat parfaite* and *imparfaite*. The absence of the third party's consent did not have any effect on the validity of the contract. Similarly, the freeing of the assignor did not affect the validity of the contract. *Cession de contrat*, unlike *cession de crédit* was a bilateral transaction and was not regulated by the Code Civil.

261. Huang inquired whether the concept of transfer of contract also covered mergers between companies. Fontaine replied that such mergers could be considered voluntary but, generally, were governed by special rules. In countries where there were no such special rules merger contracts could be governed by the Principles.

262. According to Schlechtriem the question was complicated by the fact that mergers could come about in a variety of different ways, i.e. by the restructuring of legal personalities or by transfer. He believed it would be difficult to draft rules dealing with all possible situations. If the merger occurred by the transfer of one business to another it was just a transfer of contracts, while if it occurred by restructuring it was something different and the Principles should not attempt to regulate it.

263. Bonell thought it was not a normal contractual transfer. The transfer of a single contract was one thing but the transfer of a business was another. The subject matter of the deal would be the business, which was made up of many ongoing contracts. Under Italian law there would be *successione a titolo universale*, transferring

the entire bundle of contracts without the need for further formalities with respect to each contract, subject to the continued existence of the liability of the transferor of the business. It was an indirect voluntary transfer of contracts.

264. Furmston made the case of A entering into a contract with company B to write a book on the law of contracts. Over the years the ownership of B changed. The position under English law was simple: B remained the contracting party throughout the changes, and it was simply the shareholders who changed. A different case was where the business was not sold, but instead purported to sell a number of contracts to write books to another publisher. The authors considered this to be legally ineffective as they had entered into a contract with B which was unassignable with the result that B had to pay the authors a transfer fee. It was thus, impossible to transfer block contracts. If the books had been written B would have been able to transfer the copyright, but it could not transfer A's obligation to write the book or its obligation to publish it.

265. Jauffret-Spinosi objected that all contracts entered into *intuitu personae* were non-assignable.

266. Furmston thought it would be difficult to deal with sale of business and transfer of contracts without dealing with delegation of duties. He thought the Rapporteur would have to deal with that issue before turning to the question of transfer of contracts.

267. Finn agreed but pointed out that it would be easier and more constructive to make comments once an initial paper had been produced.

268. The Group decided that the topic of assignment of contractual rights and duties should be given priority and appointed Fontaine as Rapporteur.

(d) Contracts for the benefit of third parties

269. Bonell called upon Lando to illustrate the approach adopted by the European Principles on the question of contracts for the benefit of third parties.

270. Lando explained that they had basically adopted the civil law approach, i.e., it was possible for two parties to agree to confer rights on third parties. The fundamental question in this respect was whether the third party could immediately claim the right on the basis of the agreement or whether the third party had first to be informed of the conferral. The common lawyers in the European Commission had no problems with this approach, possibly because the English Law Commission had at some point advocated the possibility of agreements conferring rights on third parties. Although an entire section could have been devoted to third party rights the Commission had preferred to deal with it in a single article (Article 6.110).

271. Bonell wondered whether the Group could follow the approach taken by the European Commission.

272. Farnsworth stated that the Rapporteur should consider also the Restatement Second which adopted the same solution as the European Principles by slightly different means and contained some additional rules not contained in the European Principles. He found paragraph 1 of Article 6.110 of the European Principles was based on the assumption that the vesting of the right of the third party would occur once there had been reliance by that party. Yet, as it was very difficult to prove reliance and to determine at what point there had been sufficient reliance, the § 311 of the Restatement provided for an alternative rule, i.e. the stipulation in favour of the third party would become irrevocable when the third party indicated its assent to it. He thought that the Group might want to consider including the alternative. He also believed that the Restatement contained provisions on the related question of the extent to which the promisee could sue the promisor for damages in case of breach of the promise by the latter. He thought that this issue could be addressed in the comments.

273. Schlechtriem thought that the comments should also address the question whether the promisee could require the promisor to perform or whether only the third party beneficiary had this right. With respect to the question whether it was possible to revoke the vesting of the benefit in the third party, he observed that in insurance business it was a common practice for A to take out a policy in favour of B, but retaining the right to change the beneficiary at a later date. He wondered whether A would be estopped from changing the beneficiary if B relied upon being named beneficiary.

274. Farnsworth replied that the rule should make it possible for the assignor to expressly provide to the contrary. This was always the case in insurance contracts in the United States, unless there were special tax considerations. In such cases the entire subparagraph three would not be applicable, nor would it be possible to vest the interest by giving notice.

275. Di Majo agreed that the Principles should contain a provision on contracts for the benefit of third parties. This was not possible in Roman law, *nemo alii stipulari potest*, but it was now provided for in Italian civil law. Such contracts were very important in current practice and not only covered the transfer of obligations such as credit, but it was also possible to transfer property to third parties. He added that he thought there was a difference between transfer of contractual rights to thirds and the transfer of the right of performance to third parties.

276. According to Schlechtriem this was the case where only the promisee could require performance to the benefit of the third party, but did not consider this to be a true case of contract for the benefit of a third party, since the third party itself would not be able to claim performance.

277. El Kholy reported that the system was well-established in Arab law. The Egyptian civil code contained additional provisions on the nature of the right acquired by the third party. The European Principles did not make clear whether it was a direct right or not. French and Arab law considered it a direct right. In life insurance cases, this meant that the amount to be paid to the beneficiary did not form part of the estate of the deceased. Furthermore, all the pleas and defences could not be opposed to the beneficiary because the right vested in the beneficiary was new and direct. He also raised the possibility of the beneficiary's tacit acceptance of the benefit.

278. Fontaine agreed that the European Principles did not address the question of whether the promisor could set up against the third party the defences it had against the promisee/transferor. There could be different solution.

279. Lando pointed out that in the European Principles it was stated in the comments that the promisee could require performance. If the direct nature of the right vested in the third party meant that the promisee could no longer require performance once the right had been transferred to the third party, he thought that the rule should contain a provision to the contrary because it was preferable to allow both the promisee and the beneficiary to require performance.

280. Finn pointed out that Australia adopted the same approach as the Restatement

281. Furmston found the European Principles' rule acceptable but believed it did not go far enough. He believed that it would be difficult to identify which of the contracts which conferred a benefit on a third party also conferred a right to sue. The test was phrased in very broad terms which made it difficult to apply. He gave the example of A, who had a contract with the university to, *inter alia*, give lectures. It was an express/implied term of the contract that the lectures be given with reasonable competence and skill. If A performed the contract a benefit would be conferred on the students. It was not self-evident, however, that the students had a right to sue A in contract if this was not the case. Different legal systems could give different solutions. The Principles should, in his view, address the question of how to distinguish between those contracts whose performance conferred a factual benefit on third parties from those contracts which conferred a legal benefit on third parties. There was extensive jurisprudence on the issue in the United States, which the Group ought to consider. A second difficulty arose in regard to subparagraph 3 of Article 6.110. In his view there were some cases in which the parties should not be able to deprive the third party of the benefit of the contract, at least once that party had relied upon it. An example would be where A contracted with a motor insurance company providing that the company would cover any driver driving A's car with A's permission or specific drivers driving with A's permission. This was one of the statutory exceptions to the doctrine of privity of contract in England. If A's daughter had an accident when driving A's car, although she was not a party to the contract with the insurance company, she would be covered and have an enforceable claim. Furmston thought that it should not be possible to take this

right away from A's daughter, at least once she had started driving the car. He thought there were many other examples of this kind, in which the tests should be wider or different from those envisaged in subparagraph 3.

282. Jauffret-Spinosi pointed out that in French law the promisee could clearly request the execution of the contract for the benefit of the third party. In addition to the original contract there was also an obligation for the benefit of the third party. The fact that a right had been granted to a third party did not mean that the original relationship between the two parties no longer existed.

283. Schlechtriem thought the answer depended on the nature of the contract between the promisor and the promisee. He gave the example of A making a contract with a driving school for driving lessons for his/her children. It could be that the children had the right to sue the driving school for their services. He thought it was not feasible to list all possible contracts and make a burden of proof rule for each type.

284. Bonell pointed out that if the contract for the carriage of goods made express provision for the third party as the consignee, the latter would normally have a right to sue the carrier. Yet in general there was clearly a problem. He did not consider it possible for the Group to proceed much further at this stage.

285. Schlechtriem noted that German law employed the concept of third party beneficiaries to cure shortfalls in tort law. He felt that there should be a comment dealing with the issue but believed that the doctrine of "Verträge mit Schutzwirkung für Dritte" should not be addressed by the Principles.

286. Fontaine added that it could be possible to have a chapter on the effects of contracts on third parties in general, made up of three provisions: one stating the principle that contracts in principle do not have effects other than on the contracting party; secondly, stipulation in favour of third parties and, thirdly, *promesse du fait d'autrui*, provided for in a number of civil codes, including the Quebec code which in Article 1443 provided that no person may bind anyone but himself and his heirs by a contract made in his own name, but that a person may promise, in his own name, that a third person will undertake to perform an obligation in which case the former is liable for injury to the other contracting party if the third person does not undertake to perform the obligation as promised. This was a frequent scenario in practice.

287. Farnsworth thought that Fontaine's point should be included in the comments to the rule. Bonell believed that *Drittwirkung* might likewise be included in a comment.

288. The Group decided that the topic of contracts for the benefit of a third party should be given priority and appointed Furmston as Rapporteur.

(e) Set-off

289. Opening the discussion on set-off Farnsworth wondered what the Group actually meant by set-off. He made the case where A owed B some money in connection with a contract and did not pay it in full. A would be in breach of contract, but is A still in breach if it offers to pay B the difference between what it owes B and what B owes A in relation to another contract? In other words is A entitled to unilaterally subtract B's debt vis à vis A from A's debt vis à vis B? And if so, what is the difference between such a scenario and price reduction? A second possibility would be that set-off is confined to judicial proceedings, i.e. it occurs only once B sues A for non-payment of its debt and A requests that the court in its judgment takes into account B's unpaid debt vis à vis A. Farnsworth admitted that he was uncertain as to the precise answer even from the point of view of U.S. law since the Uniform Commercial Code expressly provides for the party's power to subtract sums owed during the course of performance of a contract, but almost all the reported cases fell within the second scenario.

290. For Bonell this was one of the key questions, namely, whether set-off was a matter of procedure or substance. If the matter was considered one of procedural law, the set-off could only be declared by a court, while, as was the situation in all civil law systems, if it was a matter of substantive law, it operated by a party's unilateral declaration.

291. Fontaine pointed out that there were three types of set-off in Belgian law: automatic set-off, i.e. by operation of law, set-off by agreement and judicial set-off. Automatic set-off, as described in Farnsworth's first scenario, operated only where certain conditions occurred, for example the sum to be set-off had to be certain. If the parties agreed to set-off, the same legal conditions did not have to be satisfied. Finally, if the criteria were not satisfied and the parties could not reach agreement the issue could be taken before a judge, who would be requested to liquidate the debt and set it off against the other one.

292. Schlechtriem remarked that even if set-off by unilateral declaration was possible, if the parties did not agree they would have to go to court and ultimately it would be up to the court to determine whether the set-off by unilateral declaration could and did take place. The difference was a dogmatic one. In the common law set-off was brought about by the court decision, while in civil law systems it was brought about by the parties and was merely recognised by the court.

293. Bonell objected that the scenario where the parties were unable to agree the set-off could not necessarily be equated with the court actually effecting the set-off itself.

294. Furmston observed that the position under English law was more complicated. There were a variety of different scenarios: running accounts, where there were many transactions on either side, but it was the balance from day to day that was

owed. This was an example of multiple transactions giving rise to a single action. Then there was the case of a counterclaim, similar to Farnsworth's first example. The position under English law in this respect is as follows: while in court proceedings parties can raise completely unrelated issues except for the fact that they involve the same parties, outside the courts it was not possible to take account of such unrelated claims. In between these two extreme cases lie what may be called the true cases of set-off, i.e. where claims arising out of the same contract are set off against one another. Many contracts contained provisions preventing such set-off and the House of Lords had held that in principle the parties could modify the rules on set-off almost in any way they liked. The general principle, however, was that it was possible to set-off a genuine claim arising out of the same transaction and it was only necessary to pay the balance. This was also possible in labour contracts, the leading case concerning teachers' contracts of employment. Set-off in this context did not depend on a judicial decision.

295. Bonell noted with surprise that the common lawyers in the European Commission had indicated that set-off was a procedural issue. If set-off was to be more or less equated to price reduction, as Furmston's intervention had indicated, the situation was much more complicated. For the purpose of set-off under civil law the two claims did not have to arise from the same transaction, but had to be liquid, certain and of the same nature.

296. Schlechtriem pointed out that the concept of set-off under civil law was much broader than price reduction as envisaged by common law. Some types of claims, like wages, were exempted from the scope of the set-off rules on the grounds of public policy.

297. Farnsworth explained the position in the United States which was more retrograde than English law. There was the same running account possibility and the same notion of claim and counterclaim. Whether or not unilateral subtraction was possible depended on whether the contract was for the sale of goods or not. If it was, a provision of the Uniform Commercial Code provided that subtraction was possible. The position for other contracts was unclear. He thought it would be a good thing if the Principles addressed set-off and allowed some form of non-judicial set-off.

298. Finn wondered whether there was a risk, if an error or miscalculation occurred, that the issue would fall into the area of breach. Schlechtriem agreed that if there was an error in calculation and the wrong sum was set-off as a result, then the party would be in breach of contract if the error was subsequently discovered.

299. Fontaine pointed out that one of the conditions for set-off in civil law systems was that the amount of damages had to be certain and liquid. It was, therefore, not possible in a construction contract to reduce the price by 10% because the work had not been carried out properly.

300. Bonell pointed out that the common law and civil law concepts were very different. Set-off under common law came very near to what civil systems termed price reduction, while the civil law concept was much broader and covered set-off between unrelated claims.

301. Farnsworth stated that he had nothing against price reduction if it entailed subtracting an amount from the original sum owed because of non-compliance with contractual requirements. What he did object to was a formula which gave an unfair award.

302. Schlechtriem made the case of a party to two contracts who had to pay under the first and had a counter claim for breach of the second. It was possible to set-off the money owed under the first contract from the damages owed in respect of the second. This was not set-off in the traditional sense.

303. Bonell pointed out that if with respect to breach of the second contract damages were claimed, this was a counterclaim to be brought before a court which then would liquidate it and set it off against the first debt. Yet this was not set-off in the civil law conception, which operated by mere declaration or even automatically and which, by its very nature, presupposed obligations of the same nature, of a precise amount, already liquidated and undisputed. Bonell further wondered whether it was felt that the rules on set-off should also cover the party's right to deduct, for example in case of delay, a certain amount from the price. He personally was rather surprised at such an approach which appeared to him to be a counterclaim.

304. Furmston gave the facts of one of the leading English cases and inquired what answer civil law would give. Two parties had claims against each other arising out of a contract for the carriage of good by sea. One of the claims was a claim controlled by the Hague Rules which had a one year limitation period while the other was a claim which had a six year limitation period. The owner of the goods paid what he regarded the balance, that is, the freight less the damage to the goods. The claim for damage to the goods had the one year limitation period and that for freight had the six year period. The carrier waited for 15 months and then made a claim for the balance of the freight.

305. Schlechtriem replied that it depended on how the rules on set-off were drafted. If it was *ipso iure compensatur* as in French law, i.e. that the claims are extinguished the moment they are in a set-off position, then the running of the limitation periods was irrelevant. If the approach was the same as in German law, i.e. that a unilateral declaration is necessary, it would still be possible to have a rule providing that if there was a chance to set-off before the limitation period ran out, then it could be done retroactively going back to the time when it was first possible. Yet this did not affect the basic issue, i.e. whether set-off was possible in such a situation.

306. Bonell agreed with the solution but pointed out that in his answer Schlechtriem had stated that it was possible provided the two claims were in a set-off

position. This meant that the claims had to satisfy five conditions: there had to be a *concursum debiti and crediti*; both debts had to be of the same nature and liquidated; the cross-claim had to be enforceable; and the principal claim had to be payable.

307. Schlechtriem agreed with the requirements but pointed out that in practice the party relying on set-off as a defence would always say that all the requirements had been met, while the other party would dispute it. He wondered whether the Principles should try to avoid the abuse of the set-off defence which often prolonged litigation.

308. Farnsworth pointed out that if one party had subtracted amounts owed and the issue was brought before a judge there would be a great difference depending on whether the law permitted or prohibited parties from themselves making reductions. He added that in the common law there was a distinction between set-off and counter-claims depending on whether the claims arose from the same or different transactions, while civil law systems did not emphasise the difference. In the common law on the other hand it did not matter whether the amount subtracted was liquidated. There were thus a number of difference between the two concepts.

309. Finn wondered whether set-off would not be available under civil law if one party disputed the debt, no matter how unreasonably.

310. Fontaine replied that in such a scenario a court would have to determine whether the conditions had been met.

311. Bonell asked whether the Group agreed that under the Principles set-off should operate independently of a court intervention, and that certain conditions had to be fulfilled, for instance, that the two obligations related to one and the same contract.

312. Furmston replied that under English law the concept of set-off was limited to claims arising out of the same transaction but which did not have to be crystallised claims.

313. Fontaine inquired how the common law systems solved the question of claim and counterclaims in contract and tort if set-off had to arise from the same transaction. Furmston replied that if the parties were unable to settle the matter amicably they would have to go to court, have two judgments and the balance would have be paid. In England it would not be possible to defend the action for the price of one contract by pleading that a greater sum was owed in a different transaction. They were two separate actions. But it was common to have contractual provisions altering these rules and permitting set-off in respect of separate transactions.

314. Schlechtriem wondered whether, if both the contract and tort claims had already been adjudicated so that there were two money judgments, it would be possible to set-off the two. Finn said that it would not be possible to set-off the two and there would be two separate enforcement proceedings.

315. Komarov thought it would be more useful if the Principles did not limit set-off to transactions arising out of different contracts as was the case in Russian law.

316. Schlechtriem suggested that all the topics which had been discussed plus set-off in bankruptcy should be addressed by the rapporteur. Bonell was reluctant to include the last topic in view of its complexity.

317. The Group decided that the topic of set-off should be given priority and appointed Jauffret-Spinosi as Rapporteur.

(h) *Waiver*

318. Bonell called for comments on the desirability of the including waiver in the Principles, its feasibility and the approach to be taken in dealing with it.

319. Finn explained that at common law there were three terms which, to some extent, overlapped: waiver, estoppel and election. Estoppel was reasonably well-known. It was a reliance-based remedy and/or defence in Australia and the United States. Election was not a reliance-based notion but arose when a party faced with several possibilities made a choice and was prevented subsequently from going back on this. Waiver was, in Australia, a concept somewhere between the two and not very precisely defined.

320. El Kholy pointed out that the concept of *wavier*, or *r nonciation*, was very important and under civil law could not be presumed. Bonell remarked that *r nonciation* was not identical to the common law notion of estoppel, but was instead closer to the concepts of novation and discharge, while waiver was closer to estoppel.

321. Schlechtriem was of the view that general concepts, such as waiver, should not be taken out of context. They were used to remedy deficiencies in legal systems and, therefore, had different meanings in the different legal systems depending on the lacuna they were intended to fill. It was necessary to determine where they were needed in the context of the Principles by identifying the deficiencies that should be remedied by a general concept such as waiver. Schlechtriem believed that waiver might be an additional tool in the forthcoming prescription topic. Care should be taken to ensure that waiver would not be used to overturn decisions taken in drafting other topics. The rules on waiver should not be drafted too broadly.

322. Bonell pointed out that there already were provisions in the existing Principles that could be considered particular applications of the general principle of waiver.

323. El Kholy observed that the concept of unilateral discharge or *remise de dette*, did not exist in Egyptian law. The debtors acceptance was always necessary. It was therefore an agreement.

324. Farnsworth was surprised to find the concept described as waiver. He did not think this was a term that could be easily translated from the English and it was not clear whether the term had the same meaning in different common law systems. He suggested that it might be preferable to define the concept rather than use an unclear term. The question concerned the effect of conduct during the performance of a contract. For example, if there was a condition but the recipient did not insist on its performance, would he or she later be precluded from asserting the condition or, where there was a right and the beneficiary disregarded it, had he or she relinquished the right? He added that if the Group wanted to draft rules on conditions it might also want to address the situation in which a person, who could assert a condition, was precluded from doing so by virtue of having disregarded it. Whether or not there had been reliance on the disregard could be a relevant factor. The circumstances in which a party gave up a right to money or performance by conduct was distinct but could also be addressed.

325. Bonell asked whether the Group accepted as a starting point the summary of the concept given in Doc. 55 (“the loss of a party’s right or defence as a consequence of its conduct which lead the other party reasonably to believe that it no longer wishes to exercise its right or rely on the defence”).

326. Finn supported Farnsworth’s description of the subject as conduct in a relationship, namely reasonable reliance on an assumption induced by the other party. Reasonable reliance in the process of a contract was not coterminous with the explanation just given which referred to “loss”. What if a representation was made that a right would not be exercised at a particular time or would only be exercised in a particular way? There was no loss. Instead, it was the classic English notion of promissory estoppel, where if one wanted to go back to the original *status quo*, one had to give reasonable notice of this intention to the other party to enable him/her to adjust. Another example arose in the context of contracts for the benefit of third parties, where the right for the beneficiary deriving from the contract arises as a consequence of the the beneficiary’s reliance on an induced assumption. There was a range of situations where the concept could arise, defensively or offensively.

327. Fontaine thought the description in Doc. 55 a good one but agreed that specific terms should not be used. He thought it was an important subject, especially in international contracts, as the issue had been raised in a number of international arbitrations.

328. In relation to implied waivers El Kholy wondered whether clear rules of interpretation could be laid down in the Principles.

329. Komarov supported the inclusion of the topic and thought that the rules on waiver should promote the application of one of the general principles of the Principles, i.e. good faith and fair dealing.

330. Bonell observed that for practical reasons waiver was not one of the topics on which work would commence immediately. This meant that when the time came to address this principle in general terms specific rules would already have been drafted on particular applications, such as agency by estoppel, possibly directors' liability and the effect of negotiations on the running of the prescription period.

331. Schlechtriem agreed that it was preferable to have specific rules so that it would be possible to identify the areas where they would have to be supplemented by a general principle. Such a clause was necessary in every legal system to provide flexibility but care should be taken to prevent it from undermining the rules.

332. Uchida observed that the concept of waiver was difficult for him to understand and was not persuaded that it should be addressed specifically in the Principles as it appeared to him to be just an aspect of the general principle of good faith and fair dealing. If it emerged that the rules on the concept could only be formulated in a general manner he did not believe their inclusion would be beneficial. Schlechtriem thought that following Uchida's approach it would be sufficient to expand the comments on good faith and fair dealing to say that they included the notion of waiver or estoppel.

333. Jauffret-Spinosi thought the subject would give rise to difficulties: reliance was a common law concept unknown in French law. In French law there existed the related notions of acquiescence and renonciation. She thought it would be difficult to lay down definitions as it was essentially a question of fact.

334. Furmston thought that the issue should be addressed but only once the other specific issues had been considered. It was a complex area and he suggested that a number of situations should be identified where one of the doctrines of waiver, estoppel and election applied and see if the issues they raised had already been addressed by the other rules in the Principles or whether there were any outstanding areas that should be dealt with in a specific rule.

335. Bonell inquired whether the Group agreed that any intentional renunciation should be outside the scope of the proposed rule which would focus on conduct and reliance.

336. Schlechtriem thought that there may be problems as some considered a *remission* was a contract between the parties. He asked whether the concept of unilateral release was recognised by common law or whether it required acceptance of the release.

337. Furmston replied that the common law may have different solutions. In England some remedies could be lost by election which did not require any action by the other party. There were other situations where the effectiveness of conduct in extinguishing or qualifying a right depended on the other party's reliance. This was unilateral discharge and discharge by agreement.

338. Farnsworth commented that the extent to which it was possible to relinquish a right by agreement was somewhat unclear and unsatisfactory in United States common law. He did not feel particularly tied to its restrictions. Finn agreed.

339. Huang observed that the term waiver had been imported into the Chinese system as "give up" and was quite common in banking or loan agreements. Often such clauses were inserted at the insistence of the stronger party and she was not sure whether this could be considered an agreement. Bonell thought that this was essentially a question of unequal bargaining power, possibly covered by Rule 3.10 on gross disparity. With regard to waiver, it was envisaged that the rule would focus on conduct rather than agreement.

340. The Group decided that the topic of waiver should be given priority and appointed Finn as Rapporteur.

(g) *Price reduction*

341. Introducing this topic Bonell observed that there were a number of international instruments, including the Vienna Sales Convention and the European Principles, addressing price reduction, and wondered whether the Group wished to depart from the approach adopted therein.

342. Schlechtriem pointed out that price reduction was a familiar concept to civil lawyers while the common law dealt with the issue in the context of damages. Price reduction could however operate quite differently from a claim for damages. In his view the concept of price reduction could be applied to contracts other than sales of goods but this approach had been rejected by the German Law Reform Commission. He believed that, if price reduction were to be included, the major issue to be addressed was how reduction would operate. Price reduction could be brought about in many ways: firstly, by unilateral declaration, as in the Vienna Sales Convention; secondly, by means of an agreement entitling a party to reduce the price as in the warranty section of the German Civil Code; thirdly, reduction *ipso facto* and finally, by application to a court. Each approach had its advantages and disadvantages. For example, if price reduction was effected by means of a unilateral declaration the party was bound and would be unable to switch to a different remedy at a later stage.

343. El Kholy observed that many Arab countries had a public policy rule providing that an agent's fees could be reduced if they were disproportionate to the services actually rendered and agreements to the contrary were null and void.

344. Farnsworth recalled that he had participated in UNCITRAL in the discussions on price reduction. He felt that there would be resistance in the United States to the extension of the concept to contracts other than sales contracts. He understood that there might be instances where a party could receive more by means of price reduction than by way of damages. This would be a problem in the United States where the basic principle was that a party should not receive more than its expectation interest. He concluded that he was not in favour of including this topic in the Principles and was against its use as an alternative to damages. He thought that perhaps it should be considered in the context of *force majeure* and impracticability when the existing Principles were revised.

345. Lando replied that common lawyers often raised the objection that a party should not receive more than its expectation interest and if the expectation interest is nil then the party should not get any price reduction either. Nordic countries took the opposite stand. If a party had made a bad bargain and had a nil expectation interest, if the item was only worth half the value of what the buyer had thought it would be worth, the buyer would be entitled to a 50% price reduction. He concluded that he strongly favoured the inclusion of the topic.

346. Furmston thought that although English lawyers would not be familiar with the concept of *actio quanto minoris*, they would not be surprised by the result reached in Article 50 of the Vienna Convention because of the rule in *Mandela Steel* which stated that if the goods delivered were defective the purchaser could pay less than the full price. The manner in which the reduction was calculated might be different. But the notion that in a sales contract the buyer might pay less than the full price if the goods were defective was recognised by common law. Outside the field of sales contracts the notion was discussed in the context of set-off.

347. In reply to a question on the relevance of force majeure, Schlechtriem explained that common law always granted the remedy of damages and therefore there was no scope for price reduction in situations other than force majeure where, as a rule, no damages could be awarded. For example in the case of a construction contract, where the work had been partially completed before the occurrence of force majeure, an *actio quanto minoris* would be appropriate.

348. Farnsworth observed that in the context of the Vienna Sales Convention price reduction had only been advantageous in cases where there had been an abrupt and large market shift. This was fine for the sale of goods but he wondered whether similar shifts ever occurred in the context of construction contracts. If the application was thus limited, the subject would be of limited practical importance. Schlechtriem replied that there were such shifts in the real property rental market.

349. Furmston inquired whether in the construction contract example the force majeure had occurred halfway through the performance of the contract. Why should the price be reduced if the work was eventually carried out, albeit late. Contracts normally contained express provisions permitting extra payment or time for completion in the case of a delaying event which was not the fault of the contractor. Price reduction was not relevant in those cases. Schlechtriem replied in his experience that price reduction was a welcome remedy in construction contracts.

350. The Group decided that, in view of the differing opinions that had been expressed on the advisability of the inclusion of the topic and the fact that no one had considered it a priority topic, price reduction should not for the time being be taken up as a new topic.

(h) Conditions

351. Bonell called for comments on the desirability of including the topic of conditions in the Principles, its feasibility and the approach to be taken in dealing with it.

352. Fontaine remarked that he was not overly keen to include the subject. If the Group wanted to draw up a complete code of obligations this was a chapter that was missing. Yet if he had to choose, e.g., between the inclusion of conditions or of joint and several liability he would choose the latter.

353. Schlechtriem pointed out that the Principles had the important function of providing lawyers from different legal systems with a common language. The section of Doc. 55 on conditions highlighted the variety of terms used in this context. If it was possible to agree on a common language by means of a provision in the Principles that would already be an achievement. In addition, he thought consideration should be given as to whether the Principles should allow potestative conditions.

354. Huang inquired whether “condition” was a legal term. For example, did the term cover conditions precedent for the existence of a contract or not. Bonell suggested that the subject should be approached in a very broad manner, thus including conditions for the coming into effect of the contract itself.

355. Farnsworth pointed out that, in addition to difficulties of terminology, there were some important substantive issues within the topic of conditions. He added that in all systems conditions operated in a draconian manner. If A said to his son that he would give him £1000 if he got 90% in the exam and the son got 89%, A was not obliged to pay. Consequently judges were disinclined to find the existence of a condition. If they found a condition, they generally looked for a way to get rid of it in difficult situations or to say it would cause excessive forfeiture. Another way of avoiding the operation of conditions was for judges to hold that they have been waived. It would thus be

impossible to discuss waiver without also addressing conditions. For this reason he thought the two topics should be discussed together.

356. El Kholy remarked that a premium for early completion was a suspensive condition which should be included in the Group's discussion. Bonell thought this was a potestative condition.

357. Lando remarked that it was difficult to distinguish between a condition and other terms of the contract. He thought the topic was very difficult to address and should be given a low priority.

358. Fontaine added that if the Group decided to address the subject, it should consider the issue of the rights and duties pending the fulfilment of the condition in general, and, in particular, the situation where the behaviour of one of the parties could affect the fulfilment of the condition.

359. Bonell summed up that the general view appeared to be that the topic of conditions should not be given priority.

360. Finn suggested that conditions permeated a number of different areas and as such might not warrant being considered independently. Farnsworth agreed but pointed out that as there were clear problems of terminology, it might be advisable to address the issue, even if just to reach common accord on what was intended by the various terms.

361. The Group decided that detailed consideration of the topic of conditions would be postponed to a later date.

(i) Other topics to be included

362. Farnsworth reported that on a number of occasions he had been asked whether the Group intended to address the question of EDI. Although he was not enthusiastic about the subject he nevertheless felt that the Group ought to address it in some way in order not to be considered outdated. He also asked whether the European Commission had addressed the issue.

363. Lando replied that the issue will be addressed sometime in the future. EDI gave rise to problems of private international law as domicile rules could not longer easily be applied. He believed that EDI had the greatest impact in relation to contract formation. However he did not think it gave rise to great difficulties as both the European and the UNIDROIT Principles already contained rules on instantaneous contracts. What should be considered was the software providing for the automatic conclusion of contracts for the sale and purchase of shares once they reached a particular target price.

364. Fontaine agreed that some of the issues raised concerning EDI were not really new. He considered the most important problem was that of the authentication of documents and of electronic signatures.

365. Bonell recalled that UNCITRAL had set up a permanent working group six years ago which had produced a model law on electronic commerce. There were few contractual issues that had to be addressed other than authentication.

366. Farnsworth suggested, that in order to show that UNIDROIT was considering the issue, a member of the Group should prepare a paper indicating the areas on which the Principles could include references to electronic commerce. He thought Uchida, being a member of the UNCITRAL Working Group on EDI would be an ideal candidate.

367. Bonell asked Uchida whether he would be prepared to carry out this task and Uchida accepted.

368. El Kholy wondered whether the Group intended to address questions of evidence. Bonell replied that it was not envisaged.

369. With respect to the other topics which were being considered by the European Commission, Bonell recalled that Farnsworth had suggested that the question of the effects of illegality and immorality on contracts be addressed and he hoped this topic would be addressed at some later stage.

370. Farnsworth suggested that if the Group decided to address an additional topic, a members of the Group should be entrusted with preparing a document along the lines of Doc. 55 which the Group could use as an agenda item at a future meeting.

371. Farnsworth moreover suggested that it might be useful to draft a provision which parties could employ to incorporate the Principles into their contract and volunteered to prepare a draft model clause. He wondered whether in addition another clause could be drafted for parties wishing to incorporate the Principles together with a specific domestic law into their contract.

372. Bonell considered this an important suggestion and an issue which had been raised in a number seminars. He added that the American Law Institute was currently discussing the extent to which the new version of the conflict of law provision in Article 1 of the UCC could make reference to instruments such as the Principles.

373. El Kholy thought it would be unlikely that parties to international arbitrations would choose to combine the Principles and domestic law as this was likely to give rise to uncertainty.

IV. WORKING METHOD

374. Furmston asked what the Goup's proposed workplan was.

375. Bonell said that the ideal timetable would be to hold each year at least one plenary meeting plus some shorter informal sessions of the Rapporteurs. He was uncertain, however, whether the Institute could bear the financial burden of such a schedule. He invited the members of the Group to explore the possibility of hosting future meetings in their own countries, thereby alleviating the Institute's costs. In this connection he hoped to convince the newly established School of Economics of the Free University of Bozen/Bolzano in South Tyrol to host the next meeting of the Group scheduled to be held in February 1999.

376. In view of the fact that six new topics have been chosen as priority items and that Farnsworth and Uchida had been asked to prepare additional papers, Furmston asked what would be on the agenda of the Group's next session.

377. Bonell suggested that for the next session position papers be prepared on agency, limitation of actions, assignment, set-off and contracts for the benefit of third parties, while that on waiver and EDI could be presented at a later stage. As soon as preliminary drafts on each of these topics are prepared they could be discussed first by the Rapporteurs at informal meetings before being submitted to the Group as a whole.

378. Farnsworth agreed with the suggested approach although he thought that it would hardly be possible to consider more than four major subjects at any one annual session.

379. Bonell shared this opinion. However in view of the urgency of a model clause for the incorporation of the Principles into a party's contract, he wondered whether Farnsworth was prepared to present a draft at the Group's next session. Farnsworth agreed.

380. As there was no further business on the agenda, Bonell closed the meeting.