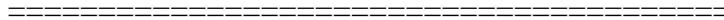


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WORKING GROUP FOR THE PREPARATION OF
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

Article X

INCONSISTENT BEHAVIOUR

(Draft Article with Comments prepared by Justice P. Finn)

Rome, April 2003

Article X
(Inconsistent Behaviour)

A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has relied unless it can do so without occasioning detriment to that other party in consequence of its reliance.

COMMENT

1. Inconsistent Behaviour and “good faith and fair dealing”

This provision is a general application of the principle of good faith and fair dealing (Art 1.7). It is reflected in other more specific provisions of the Principles. See, for example, Arts 2.4(2)(b), 2.18 and 2.20. It imposes a responsibility on a party not to occasion detriment to another party by acting inconsistently with an understanding concerning their contractual relationship which it has caused that other party to have and upon which that other party reasonably relied.

The prohibition contained in this article can result in the creation of rights and in the loss, suspension or modification of rights otherwise than by agreement of the parties. Compare Arts 1.3 and 3.2. The article does not provide the only means by which a right might be lost or suspended because of one party’s conduct. See, for example, Articles 3.12 and 7.1.4(3).

Note: Is there to be a specific provision on renunciation of prescription?

2. An understanding reasonably relied upon

There is a variety of ways in which one party may cause another to have an understanding concerning their contract, its performance, or enforcement. The understanding may result, for example, from a representation made, from conduct or from silence when a party would reasonably expect the other to speak to correct a known error or misunderstanding that was being relied upon.

So long as it relates in some way to the contractual relationship of the parties, the understanding for the purposes of this article is not limited to any particular subject matter. It may relate to a matter of fact or of law, to a matter of intention or to a present matter, or to how one or other of the parties can or must act.

The important limitation is that the understanding must be one on which, in the

circumstances, the other party can and does reasonably rely. Whether the reliance is reasonable is matter of fact in the circumstances having regard, in particular, to the communications and conduct of the parties and to the expectations they could reasonably entertain of each other.

Illustrations

1. A has negotiated with B over a lengthy period for a contract of lease of B's land under which B is to demolish a building and construct a new one to A's specification. A communicates with B in terms that induce B reasonably to understand that their contract negotiations have been completed and their contract will be executed. B then demolishes the building and engages contractors to build the new building. A is aware of this and does nothing to stop it. The contract is never executed. A later indicates to B that it does not intend entering into the contract. A will be required to execute the contract.
2. B mistakenly understands that its contract with A can be performed a particular way. A is aware of this and stands by while B's performance proceeds. B and A meet regularly. B's performance is discussed but no reference is made by A to B's mistake. A will be precluded from insisting that the performance was not that which was required under the contract.
3. A regularly uses B to do sub-contract work on building sites. That part of A's business and the employees involved in it are taken over by A1, a related business. There is no change in the general course of business by which B obtains its instruction to do work. B continues to provide sub-contract services and continues to bill A for work done believing the work is being done for A. A does not inform B of its mistake. A is precluded from denying that B's contract for work done is with it and must pay for the work done.
4. Because of difficulties it is experiencing with its own suppliers, A is unable to make deliveries on time to B under their contract. The contract imposes penalties for late delivery. After being made aware of A's difficulties, B indicates it will not insist on strict compliance with the delivery schedule. A year later B's business begins to suffer from A's late deliveries. B seeks to recover penalties for the late deliveries to date and to require compliance with the delivery schedule for the future. It will be precluded from recovering the penalties but will be able to insist on compliance with the schedule if reasonable notice is given that compliance is required for the future.

3. Detriment and preclusion

The responsibility imposed by the article is to avoid detriment being occasioned in consequence of reasonable reliance. This does not necessarily require that the party seeking to act inconsistently must be precluded from so doing. Preclusion is only one way of avoiding detriment. There may, in the circumstances, be other reasonable means available that can avert

the detriment the relying party would otherwise experience if the inconsistent action was allowed as, for example, by giving reasonable notice before acting inconsistently (see Illustration 3), or by paying for costs or losses incurred by reason of reliance.

Illustrations

5. A and B are parties to a construction contract which requires that additional works be in writing and be certified by the site architect. A's contract manager orally requests B to do specified additional work on a time and materials basis and assures B it will be documented appropriately in due course. B commissions design works for the additional work at which stage A indicates that the work is not required and offers to pay B the costs incurred in commissioning the design work which is far less than the cost that would have been incurred had the additional work been done. B cannot then complain of A's inconsistent behaviour.

6. A fails to meet on time a prescribed milestone in a software development contract with B. B is entitled under the contract to terminate the contract because of that failure. B continues to require and pay for changes to the contract deliverable and acts cooperatively with B in continuing the software development program. B's continued performance is based on A's conduct subsequent to the breach. A will in such circumstances be precluded from exercising its right to terminate for the failure to meet the milestone. However, under the Principles B will be able to allow A an additional period of time for performance (Art 7.1.5) and exercise its right to terminate if the milestone is not met in that period.

REPORTER'S NOTE

The responses I received to my previous paper from members of the Working Group to my enquiry (see Annex I), with one exception, favoured adoption of an article in the terms used in the draft I have prepared.

Allan Farnsworth has suggested an even more abbreviated version of it in the following terms:

A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has relied to its detriment.

I would be happy to adopt this version and to expand slightly Comment 3. However I will leave this matter to the Working Group to decide.

There is probably a little more by way of explanatory material in the Comments than is usual in the Principles. Much of it may be considered unnecessary and be able to be shortened or deleted.

Members of the Working Group may wish to provide further illustrations which they consider might assist understanding by the audiences with which they are familiar. I have refrained from using examples dealing with carriage and insurance largely because of my uncertainty about the laws of carriage and insurance outside my own system.

I should indicate in relation to Comment 1 why I have indicated expressly that the article does not provide the only means by which a right might be lost or suspended because of one party's conduct. The article requires reasonable reliance. One party's renunciation of a right or choice between inconsistent rights can result in the loss of a right, but neither requires reliance by the other party.

ANNEX I

A GENERAL ARTICLE OF INCONSISTENT BEHAVIOUR

by

Paul Finn

I have prepared the following having regard to the comments made in Rome last year. The short form proposal I put last time was in the following terms:

A party is not permitted to act inconsistently with an assumption it has induced the other party to adopt and upon which that other party reasonably has relied, unless it can do so without occasioning detriment to that other party in consequence of it having so relied.

In light of comment in Rome last year made this could be recast as follows:

A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has relied unless it can do so without occasioning detriment to that other party in consequence of it having so relied.

I have changed the language from that of “an assumption” to that of “an understanding” to accommodate (hopefully) difficulties some had with the former term. I have also made the language somewhat more emphatic.

It may be that an article in these terms would suffice if the comments illustrated the intended scope and operation of the proposal. To illustrate these I have included as well additional formulations (A2 and A3) which make explicit what is implicit in A1. A5 below, is an enlargement of A1 to A3. A4 and A6 are alternatives to A3 and A5. A7 is a modification of A1.

A8 is a true alternative to A1 to A7. It simply recasts the narrow Schlechtriem version that also was discussed in Rome.

Article X

(Inconsistent Behaviour)

- A1. A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has relied unless it can do so without occasioning detriment to that other party in consequence of it having so relied [or “of its reliance”].

OR

A2. A party cannot act inconsistently with an understanding it has caused the other to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

OR

A3. A party cannot act inconsistently with an understanding it has caused the other as a contracting party to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

OR

A4. A party cannot act inconsistently with an understanding concerning their contract it has caused the other to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

OR

A5. A party cannot act inconsistently with an understanding it has caused or has permitted the other as a contracting party to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

OR

A6. A party cannot act inconsistently with an understanding concerning their contract it has caused or has permitted the other to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

OR

A7. A party cannot act inconsistently with an understanding it has caused or has permitted the other party to have and upon which that other party reasonably has relied unless it can do so without occasioning detriment to that other party in consequence of it having so relied.

OR

A8. A party which causes the other party reasonably to understand that it will not exercise

a right or raise a defence against that other party, is precluded from acting inconsistently with that understanding if the other party has acted reasonably in reliance on it.

EXPLANATION

The first seven of the above are variations on a common theme. A1 provides the most simple formulation of the theme. A2 to A7 are formulations which qualify and/or expand the scope of A1.

A1. A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has relied unless it can do so without occasioning detriment to that other party in consequence of it having so relied.

The basic idea contained in this is a simple one. If one party causes another to have an understanding on which it reasonably relies, that party has a responsibility to that other not to cause it detriment by acting inconsistently with the understanding.

There are two principal features of the proposal. The first relates to the subject matter of the understanding. It does not limit or differentiate between types of subject matter. It may relate to a matter of fact or of law; to a matter of intention or a present matter; etc. The limitation such, as it is, is that the understanding must be one on which the other party can reasonably rely.

One consequence of not limiting the subject matter of the relying party's "understanding" is that in circumstances where a preclusion occurs, the consequence can be variously the loss of a right or a defence, the modification of a right, or the creation of a new right (or for that matter a contract).

Example I

As communications with B are such as reasonably to induce B to understand that their contract negotiations have been completed and their contract agreed. B prepares to commence performance on that understanding. The contract has not in fact been agreed. Depending upon the nature of the steps taken by B in their setting, A may be precluded from denying that a contract has been entered into with B.

The second feature of the proposal is that it does not embody an automatic and inevitable preclusion when an understanding is reasonably relied upon. Preclusion is only one way of avoiding detriment. There are others which do not require that the expectation interest be protected, eg, by giving reasonable notice before acting inconsistently, by paying for

costs/losses incurred, etc. The preclusion only takes effect if detriment cannot otherwise be avoided. In A2 this is made explicit in the text. If A1 is adopted, the comments would spell this out.

Example II

A communication from A causes B to understand (reasonably but mistakenly) that the contract can be performed a particular way. B performs it that way in reliance on A's communication. A will be precluded from insisting that the performance was not that which was required under the contract.

Example III

A communication from A causes B reasonably to understand that the contract can be performed in a particular way which is not in accordance with the terms of the contract. The contract requires periodic performance (eg the payment of money or the delivery of goods). B performs the contract from time to time in reliance on A's communication. By the giving of reasonable notice to B that it wishes future performance to be in accordance with the terms of the contract, A may be able to avert any detriment to B from having to alter its performance for the future.

A2. A party cannot act inconsistently with an understanding it has caused the other to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

This merely makes explicit what is implicit in A1. That is that the party that causes the understanding may be able to take appropriate steps to prevent or remedy any detriment that might result were it to act inconsistently with the understanding it caused the other to have.

A3. A party cannot act inconsistently with an understanding it has caused the other as a contracting party to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

This again contains an apparent qualification to what is in A1. It makes clear that the understanding must relate to the contractual relationship of the parties. This probably is implicit in A1 in any case.

A4. A party cannot act inconsistently with an understanding concerning their contract it has caused the other to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

This contains an alternative and different qualification to that in A3. The subject of the understanding must relate to the parties contract, be this its terms, its performance or enforcement. The potential significance of the difference between the qualification and that in A3 becomes apparent in the example in A5.

A5. A party cannot act inconsistently with an understanding it has caused or has permitted the other as a contracting party to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

This introduces an important extension of A1 to A4. Apart from those instances where a party (A) by word or conduct causes the other (B) to have a particular understanding, this also encompasses cases where B is labouring under a mistake not caused by A, where A is aware of B's mistake and does not inform B of it in circumstances where B would reasonably expect A to do so if A was aware of it.

Example IV

A regularly uses B to do sub-contract work on building sites. That part of A's business is taken over by A1, a related business. There is no change in the general course of business by which B obtains its instruction to do work. B continues to provide sub-contract services and continues to bill A for work done believing the work is being done for A. A does not inform B of its mistake. A is precluded from denying that B's contract for work done is with it and must pay for the work done.

This example also shows up a possible limitation of the "concerning their contract" formula used in A4 and, for that matter, in A6. The understanding in A4 and A6 presupposes the parties are in a contractual relationship. In A5 the relevant understanding may itself be that there is a contract where, but for the preclusion, there would not be.

A6. A party cannot act inconsistently with an understanding concerning their contract it has caused or has permitted the other to have and upon which that other party has reasonably relied unless, by the giving of reasonable notice, payment for expenses incurred or otherwise, it can avoid any detriment to that other party in consequence of it having so relied.

This does no more than add the “or has permitted” extension to A4.

A7. A party cannot act inconsistently with an understanding it has caused or permitted the other party to have and upon which that other party reasonably has relied unless it can do so without occasioning detriment to that other party in consequence of it having so relied.

This does no more than add the “or has permitted” extension to A1.

A8. A party which causes the other party reasonably to understand that it will not exercise a right or raise a defence against that other party, is precluded from acting inconsistently with that understanding if the other party has acted reasonably in reliance on it.

This is the Schlechtriem proposal as I understand it. It is purely defensive in character; is limited to the assertion of rights and defences; and operates in all circumstances by way of preclusion irrespective of the detriment that might be suffered by the relying party if the preclusion did not operate.

A8 is put forward as an alternative to the A1 to A7 type proposals.